PUBLICATION INFORMATION:

Waitt v. Speed Control, Inc., ___ F. Supp. 2d ___, 2002 WL 1711817 (N.D. Iowa June 28, 2002)

IN THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF IOWA
WESTERN DIVISION

NORMAN W. WAITT, JR., Plaintiff, vs. SPEED CONTROL, INC.; JAMES H. BERGLUND; EUGENE F. HUSE, JR.; NED D. MILLS; ROBERT N. TOMCHUCK; AND LOUIS E. BARTON, Defendants.	No. C-00-4060-MWB **MEMORANDUM OPINION AND ORDER REGARDING DEFENDANTS' MOTIONS FOR SUMMARY JUDGMENT**
NORMAN W. WAITT, JR., Plaintiff, vs. THOMAS C. LEVITT, Defendant/Counterclaimant and Third Party Plaintiff. vs. MATTHEW L. RIX and STEVEN W. SELINE, Third-Party Defendants.	C-00-4087-MWB

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Although venture investments can often feel more like a game of chance than a sound investment, unlike the roulette wheel, investing is a game of chance subject to changing prospects and probabilities. Companies come and go all the time, of course; it's part of the cycle of business. Losing money as a result is part of the investment gamble. However, there's a difference between losing money in an unwise investment, and losing it in a game that's been rigged against you. Here, in this litigation, the plaintiff claims the later has occurred and that he has lost his investment in a closely held corporation due to defendants' actions. Defendants, on the other hand, contend that they did not rig plaintiff's investment in the company, but that plaintiff merely made a risky investment that did not pan out.

I. INTRODUCTION

A. Procedural Background

On June 13, 2000, plaintiff Norman W. Waitt filed a diversity lawsuit against Speed Control, Inc., James H. Berglund, Eugene F. Huse, Jr., Ned D. Mills, Robert N. Tomchuck, and Louis E. Barton, C-00-4060-MWB ("the Speed Control Case"). In the Speed Control Case, plaintiff Waitt alleges that officers and directors of Speed Control, Inc. made false and misleading representations to him in order to induce him to make certain investments in Speed Control, Inc.[1]

Subsequently, plaintiff Norman W. Waitt filed a diversity lawsuit on August 25, 2000, against his former attorney, Thomas C. Levitt, C-00-4087-MWB ("the Levitt Case"). In the Levitt Case, plaintiff Waitt alleges in his complaint that defendant Levitt breached his fiduciary duties to him and committed legal malpractice with regard to investment advice he gave to Waitt with respect to Speed Control, Inc. Plaintiff Waitt also alleges that Levitt, as an officer of Speed Control, Inc. made false and misleading representations to him in order to induce him to make certain investments in Speed Control, Inc. Defendant Levitt filed an answer to the complaint and a counterclaim against Waitt for unpaid legal services, defamation, and abuse of process. On May 24, 2001, Levitt amended his answer and asserted a third-party complaint against Matthew L. Rix and Steven W. Seline alleging claims for defamation, and abuse of process, and intentional interference with a contractual relationship.

On December 31, 2001, defendant Levitt moved for summary judgment on all claims

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[1]The court notes that although plaintiff Waitt makes reference to an Iowa Blue Sky securities violation in his brief in resistance to defendants' motions, his Speed Control complaint does not cite to Iowa's Blue Sky securities law, *see* Iowa Code § 502.501 *et seq.*, nor has he alleged a violation of that statute. Therefore, the court concludes that there are no securities claims are properly before the court in this case.

against him. On January 2, 2002, defendant Levitt filed an amended motion for summary judgment. On January 15, defendants Speed Control, James H. Berglund, Eugene F. Huse, Jr., Ned D. Mills, and Robert N. Tomchuck (collectively "the Speed Control defendants" unless otherwise indicated) filed for summary judgment on claims against them. Waitt then sought and was granted an extension of time in which to file his response to defendants' respective motions for summary judgment. Waitt filed his response to the motions for summary judgment on February 6, 2002. Defendant Levitt and the Speed Control defendants then sought and were granted extensions of time in which to file a reply brief to Waitt. The defendants subsequently filed their respective reply briefs on March 1, 2002. On May 7, 2002, defendant Levitt filed a supplement to his reply brief. Before turning to discuss the standards for defendants' motions for summary judgment, the court will first examine the factual background of this case.

The court heard telephonic oral arguments on defendants' respective motions for summary judgment on June 21, 2002. At the oral arguments, plaintiff Waitt was represented by counsel Theodore R. Boecker of Sherrets & Boecker, L.L.C., Omaha, Nebraska. Defendant Levitt was represented by counsel Daniel B. Shuck and Patrick L. Sealey of Heidman, Redmond, Fredregill, Patterson, Plaza, Dykstra & Prahl, L.L.P., Sioux City, Iowa. The Speed Control defendants were represented by Maurice B. Nieland of Rawlings, Nieland, Probasco, Killinger, Ellwanger, Jacobs & Mohrhauser, Sioux City, Iowa.

B. Factual Background

The record reveals that the following facts are undisputed.

Plaintiff Norman W. Waitt, Jr. is a resident of the state of South Dakota. Defendant Thomas C. Levitt resides and practices law in the state of California. Matthew L. Rix is a resident of New Mexico and has acted as an agent for Waitt in a business and professional

capacity.

Steven W. Seline is a resident of the state of Nebraska and a licensed attorney in that state. Seline was formerly associated with the law firm of Kutak Rock in Omaha, Nebraska. In his capacity as an attorney with Kutak Rock, Seline first performed legal work concerning financial matters for Waitt in approximately1990. Defendants Ned Mills, Robert Tomchuck and Louis Barten are or were executives with Speed Control.

In June 1997, Waitt was contacted by defendant James H. Berglund, and invited to come to Berglund's home in Okoboji, Iowa, to discuss a possible investment in Speed Control. Defendant Eugene F. Huse, Jr. was also at this meeting. Both Berglund and Huse owned residences on Lake Okoboji, Iowa where Waitt also had a vacation home. Berglund and Huse were looking for another partner to invest in Speed Control. Berglund explained Speed Control's product as being a cable drive transmission for bicycles that did not have to use a derailleur system in order to shift gears.

Waitt did not view himself as a venture capitalist and generally did not like venture capital investments, having only invested in one such concern between 1991 and 1997. However, following the meeting with Berglund and Huse, on June 15, 1997, Waitt wrote to Seline and Levitt regarding Speed Control:

> I'm sending each of you a copy of a business plan for "Speed Control, Inc." I received yesterday from Jerry Huse. Jerry owns and runs the Norfolk Daily News. He and Jim Bergland (one of our neighbors on Omaha Beach who is a very experienced venture capitalist) have good track records in business and I respect both of them by knowing them as well as by their reputations.
>
> As you know, normally I'm pretty reluctant to jump in to most venture deals, but considering knowing these guys, it makes a difference. This business venture could possibly revolutionize bike transmissions which is now controlled 90% by the Japs. It could have other applications as well. They have patents and

> prototypes in place and want to raise about $3,000,000+ to grow the business. I think I understood him to say it would be sold to me at the same price they and a couple others paid. He said this project would not require my personal time if I so desire. I would like to know what you guys think of it. I'll be out of town until around 7/03 but I'll try to check in before hand. It would be beneficial if you two can discuss it as well.

Levitt App., Ex. 9, App. p. 66.

Speed Control's Business Plan included the following business mission:

> Speed Control, Inc. ("SCI" or the "Company") has developed the world's first and only, fully-operational and manufacturable continuously-variable transmission (CVT) for application on bicycles. The SCI CVT is the first major innovation in bicycle drive systems in over forty years; this unparalleled transmission is destined to have a major positive impact within a large, well established bicycle marketplace.
>
> The Company will soon initiate production and marketing of its CVT product line in North America and Europe. SCI's objective is to become *the premier* supplier of variable-speed bicycle systems. As reflected herein, the Company's plan is to capture a 20% market share of upper-end bicycles sold through independent bicycle dealers (IBDs), provide a high return to investors, achieve a sustained double-digit compound annual growth rate and achieve the industry's highest customer satisfaction rating.

Waitt App., Exp. 91, Ex. A at p.2. Speed Control's business plan also stated that it was seeking $3,000,000 in financing in order to "Move [Speed Control's] CVT products into production." Waitt App., Exp. 91, Ex. A at p.4. The plan further disclosed that: "Speed Control has completed initial product development; it has leveraged its in house design talent with independent consultants and part-time workers. Now is the time to expand operations to commercialize the Company's CVT products and technology." Waitt App., Exp. 91, Ex. A at p.27. The plan also announced that "Speed Control expects to start

manufacturing and selling its products approximately nine to twelve months after the cash infusion. Waitt App., Exp. 91, Ex. A at p.33.

On June 23, 1997, Levitt wrote to Waitt and Seline regarding his review of Speed Control's November 1996, business plan. In his report, Levitt noted the following regarding the patent technology that Speed Control was seeking to use in its CVT transmission:

> It is not clear who is the patent owner nor is it clear the placement of these patents within the field of similarly positioned patent technology. It is not possible from these materials to know to what extent, if any, other displacing technologies or similar patents would adversely impact the economic potential of the technological position of this company. No picture of a prototype nor pictures of the internal parts is provided so it is difficult to get a feeling for the type of assembly and purchasing of subcomponents that would be necessary.

Levitt App., Ex. 28, App. p. 137. Levitt also made the following conclusions:

> Since only descriptions and rough pictorial drawings rather than photographs and blueprints were provided, we are required to use some imagination to envision the precise products subject to this business plan. Further, the authors of this business plan have indicated that there is additional design work and component fabrication specification necessary before production begins. Nevertheless, this in not an appropriate reason to omit a photograph of the prototype, hence the conclusion is warranted that the prototype is sub-standard.
>
> The rough financials provided indicate, among other things, that a significant portion of the money (apparently cash) has been expended in salary and start-up costs for which very amorphous components of a business organization seem to be in place currently. Hence, the conclusion is warranted that effective design, production, and financial management is not yet in place.

> The characteristics of the proposed product as it would compete with current products in the marketplace represents a significant departure from the present commercial gear drives in the bicycle industry, but does not present such a radical departure in both design or utility that a whole industry will be reformulated. Rather, the current type of gear mechanisms in bicycles will be modernized and upgraded which, although not a radical departure, does represent a significant engineering upgrade in a well established bicycle industry. As such, a properly designed and planned market penetration can present a significant financial opportunity. However, the documents presented thus far have not indicated the extent of the patents and patent production afforded the company. Hence, at this point it is not possible to make a determination about specific positioning of this company in the marketplace regarding maintenance and exploitation of technologies. The materials present only a suggestion of technological exploitation without much analysis which ties the patent technology to the exploitation in the marketplace. Hence, the conclusions at this point is warranted that research and development (R&D) is sufficient from which marketing projections can be reasonably made.
>
> This is apparently a significant departure from current technology. With careful review of the exact nature of that departure from current technology, the potential for this type of operation in generating long-term sales in a narrow band of bicycle market probably warrants further investigation rather than summarily dismissing this as a fruitless business opportunity. The financials present a top-heavy stock ownership scheme with a suggestion of a newly available relatively small stock position (20%) for a relatively large sum of cash $3,000,000. The conclusion is warranted that degree of impact this may have on the worldwide bicycle market warrants further investigation as the next step prior to an earnest money agreement conditioned with a then in depth due diligence period.

Levitt App., Ex. 28, App. p. 135.

In early July 1997, Huse and Berglund arranged for Speed Control's Chief Executive Officer ("CEO") and President Louis Barten, and Ned Mills, the inventor of Speed Control's CVT transmission and Speed Control's chief designer, to come to Okoboji, Iowa, to demonstrate a bicycle equipped with a Speed Control transmission. Waitt was able to ride a bicycle equipped with a Speed Control transmission. During this demonstration, Mills did not mention to Waitt problems that Speed Control had experienced with the CVT's "vanes", "pawls", wear and tear on the bearings, bolts coming loose in the CVT, an inadequate number of ball bearings in the CVT, and friction associated with the CVT. Waitt App., Exp. 100, at pp. 73-74. Mills did not tell Waitt about these problems with the CVT because they were "internal" to Speed Control and items that he expected to solve because these items had to be resolved before mass production of the CVT could occur. Waitt App., Exp. 100, at pp. 74-75.

On July 15, 1997, Barten wrote to Waitt to respond to certain concerns raised by Levitt in his review of Speed Control's business plan. Barten noted that:

> The Company has operated in a fiscally conservative manner as it developed its products from concept to the current prototypes. Our approach has been to assure ourselves we had products which were: unique, functional, manufacturable and which addressed a real need in a large worldwide market. We have achieved this set of objectives.
>
> Our next goal is to move into production and initiate sales of these unique bicycle transmissions. We have an opportunity at both retail and OEM levels, domestically as well as internationally. As was pointed out in your letter, the Continuously-Variable Transmission (CVT) represents a significant departure from current gear or derailleur mechanisms used today in the bicycle industry.
>
> As you experienced during the demonstrations, the CVT is very easy to use and as you observed is free from dirt infiltration, protected from damage and requires minimum mandatory

> maintenance, especially when compared to existing bicycle derailleur products.
>
> Similarly, as was pointed out in your letter (and as was clear during the demonstration), the application of the CVT allows for installation on newly sold bicycles as well as retrofit on bicycles currently in use.

Levitt App., Ex. 27, App. p. 119.

In his letter, Barten also addressed the question of the patents at the center of Speed Control's CVT transmission:

> The Company's patent position is solid. The Company was granted its most recent patent (**Patent** number **5,632,702**) on May 27, 1997. This patent affirms the uniqueness of the Company's technology and specifically covers the transmission implementation demonstrated to you on Friday. This patent was also filed internationally under **Patent Serial No. PCT/US 96/11266** and "was found to be novel and include an inventive step over the prior art references considered by the examiner." Therefore, we are in a good position to protect our intellectual property both domestically and internationally. (A copy of this principal patent has been sent to Tom Levitt for his review.)
>
> In addition, the Company has been granted patents for its continuously-variable transmission technology for application on bicycles (**Patent No. 5,454,766**) and other applications: **Patent Nos. 4,967,615** and **4,823,627**.
>
> We believe the Company can establish a competitive edge through these and yet to be filed patents which cannot be duplicated by other manufacturers for a significant period of time. <u>All of these patents have been assigned to and are owned by the Company</u>, Speed Control, Inc.

Levitt App., Ex. 27, App. p. 120 (emphasis original).

Barten further discussed the development of the CVT transmission, with Barten

writing in pertinent part, that:

> Since the Business Plan was written, the Company has moved another significant step forward, completing its initial "Design for Manufacture" (DFM) effort. The purpose of the DFM design phase is to make the functional unit ready for manufacture. As you recall, we showed you this most recent version of our transmission during the demonstration. This mechanically-actuated hydraulic shifter is entirely contained within the rear axle, which allows the rear wheel to be removed from the bicycle without disconnecting a hydraulic line. . .
>
> . . . .
>
> . . . We are about to start testing of our DFM unit and once we have acquired the necessary funding, proceed to tooling and building key parts using the selected materials and manufacturing process. We will then enter a subsequent phase of reliability testing on the production parts. All of this testing must be successfully completed before introducing the products into the market.

Levitt App., Ex. 27, App. p. 120.

On July 29, 1997, Waitt wrote to Levitt and Seline and enclosed Barten's July 15, 1997, letter. In his letter, Waitt wrote in pertinent part:

> I have enclosed subsequent materials given to me by "Speed Control, Inc." I met with Jim Berglund and Jerry Huse today to further discuss the venture. We discussed the positives and potential negatives of the company.
>
> I expressed my concern with the product's problem with shifting gears while peddling the bike. After a discussion via phone with Ned Mills, I was assured that the prototype bike would indeed be able to down-shift to a lower gear while peddling it, however, it would be difficult if not impossible to up-shift this bike transmission while peddling it. Ned explained that the trade-off is that you can shift the bike while not peddling it (unlike the current derailing systems) which makes it much better for stop-and-go and city-type biking. Ned tells me that it's his belief that you can't have it both ways engineering wise.

> After some discussion with them, I told them I would consider an investment of between $500,000 to $750,000 ($750,000+ is what they would currently like from me) provided we are comfortable with the terms of the deal of course. The money raised (they are currently trying to raise about 1.5 million in total) would go towards beta testing the bike transmission with selected bike dealers. This money would also go for some further R&D and some minimal staffing. They seem confident that they are very close to having a salable or functional product now. I would certainly expect to see that they get the real prototype (the non totally hydraulic version that Steve and I drove second) in the working order they described. This means that it would be fully functional and easily downshift while peddling the bike. I would want them to accomplish this before I close on this deal as part of our terms.

Levitt App., Ex. 27, App. p. 108.

On August 4, 1997, Levitt wrote to Seline and Waitt following his trip to Speed Control's headquarters in Washington. Levitt reported in pertinent part that:

> 1. I rode the bicycle under various conditions. I was told that this was an upgraded version of the bicycle that Norm rode.
>
> I learned that:
>
> a. The CVT for a bicycle is operable & capable of production. The prototype is a success.
>
> b. Speed Control, Inc. (SCI) does not clearly articulate these matters and poorly presents facts. No evidence appears that this is with malice or manipulation, rather, this is an inadequacy within SCI. Ned Mills is an inventor, not an engineer. Mr. Barton is not an effective communicator in this area. Together, neither has been able to articulate the course of development nor the current stage in development. However, from my questions & inspections, I have learned much which was

previously obscure.

. . .

3. Production techniques and final materials are not specified, not even approximated! B.S.! Mills himself knows that this process must go step-by-step with small, but constant improvement. [Speed Control] is not on this track & must get there soon. Mills & Levitt connected on the feedback loop necessary for human factor testing, material & construction specifications, etc.

Speed Control App., Ex. 84, App. pp. 3, 6. Levitt went on to offer these conclusions and impressions:

1. This company is in need of a management reorganization to a degree. Several good pieces are in place, but the knitting needs to be more complete and tighter. Mr. Mills is awesome. The product is prototyped. Offices and short term production are close to ready. Need production engineering, real product development plans, and real sales, accounting and support staff. This is all very possible, in the short term. <u>But</u>, you should not consider this a mere investment. They need capital <u>both</u> because the development is not yet complete in terms of the company as a whole, but also because the current management/direction is inadequate and underperforming in my view.

   This is worth an investment because Mills & the products are awesome and easy to comprehend, engage, and establish both and entry and exit strategy.

Speed Control App., Ex. 84, App. pp. 7.

On August 6, 1997, Levitt faxed a note to Seline regarding Levitt's review of Speed Control materials sent to him by Waitt and Seline. Levitt reported that:

1. Speed Control is amassing debt @ an alarming rate and a liquidity crisis is at hand. Norm's participation will

> delay crisis and the totality of company progress together with proposed cash infusion needs more review/consideration before we can properly state our assessment. This may be enough cash @ $1.5M, but it may be insufficient. (I realize NWW is considering only $750K or $500K).
>
> 2. My remarks from correspondence to you & NWW dated yesterday continue to be accurate & are incorporated here by reference.
>
> 3, The financials coupled with our review of the company structure suggest a restructure is necessary to enhance likelihood of success.

Levitt App., Ex. 31, App. p. 144.

On August 29, 1997, Seline sent Levitt's resume to Martin Nichols, an attorney at a law firm representing Speed Control. Seline noted that: "As you remember, Tom is the party that we discussed should be added to the Board of Directors at Speed Control, Inc." Levitt App., Ex. 32, App. p. 145. Also on August 29, 1997, Levitt wrote a letter to Seline in which he commented on the Amended and Restated Article of Incorporation and Investors Rights Agreement. In his letter, Levitt advised Seline: "I recommend that you request documents regarding the assignments of patents to the corporation together with any employment or related agreements on incentives or employment conditions that would apply to key or other employees in the company, past, present, or future." Levitt App., Ex. 21, App. p. 91.

On October 3, 1997, Waitt invested $750,000 in Speed Control and received 375,000 shares of stock in the company. On November 4, 1997, Levitt wrote to Waitt and Seline regarding the status of Waitt's participation in Speed Control. In his letter, Levitt offered in pertinent part the following observations:

> This project is very compelling considering the technology and

> its implementation involving the continuously variable transmission (CVT). This company apparently controls Mr. Mills and his technology progeny. Prior to preparing this summary, I reviewed the laboratory and development facility in Kennewick on the same date, reviewed patent documents and related items, and engaged a private meeting with Ned Mills and Bob Tomchuk on October 21, 1997, together with various telephone calls over time.
>
> Conclusion
>
> Mr. Waitt's funding of this project pre-supposed the completion of some documentation after close. This was part of the atmosphere of confidence and trust in Jim Berglund and Jerry Huse, and the other two directors. This transaction with Mr. Waitt was conditioned on Mr. Waitt's naming a person for another seat on the board of directors. Technically this required proxy, given the number of outstanding shares. This proxy is implicit in the current documents, but further documents should be completed in the near future to solidify this proxy standing. The atmosphere of confidence and trust in Mr. Berglund and Mr. Huse by others in the company apparently remains and I perceive no evidence otherwise at this time.
>
> . . .
>
> The conditions that generated a need for input of capital apparently remain unchecked. Mr. Berglund and I at the last board meeting made it clear that one product line must be the subject of focus. All the potential directions previously took too much time and money without a discernable product line and clear company direction. As part of the product line focus, a sales program and manufacturing program must come to focus and gel or else the continual need for capital infusion will remain.

Speed Control App., Ex. 85, App. pp. 10-11.

On November 7, 1997, Levitt was elected to Speed Control's Board of Directors and was to serve as "the Series B Director." Levitt App., Ex. 10, App. p. 68. Waitt

envisioned that Levitt, as a member of Speed Control's Board of Directors, would monitor Speed Control and see to it that the company was being run properly.

On May 8, 1998, Levitt wrote to Seline about various financial projects that Waitt was involved in or was investigating. In this letter, Levitt mentioned that Speed Control would require additional financing in the future:

> [T]he Speed Control matter required initial capital for participation and will clearly require an additional amount of money come December 1998. Some contribution toward Speed Control will be necessary assuming Norm wishes to keep his current level of participation in the company and/or cooperative atmosphere with other investors.

Levitt App., Ex. 41, App. p. 161.

On August 28, 1998, Levitt sent a note to Seline via facsimile in which he made the following remarks regarding the financial circumstances at Speed Control:

> By way of quick update, yesterday I received a notice regarding an upcoming Board of Directors to be held in mid-September, 1998. Mr. Lou Barten, President, indicated additionally that "cash outflow is becoming critical for the company." I indicated earlier in the year, roughly January/February, that we would see a cash shortage in August or September if the then existing conditions remained unchecked, but I got the clear assurance then from Mr. Barten that this condition of "critical" would not arise until at least December, 1998.
>
> Under the circumstances, you can probably expect Jim Berglund and Jerry Hughes to make an approach to Norm in the very near future regarding placement of additional cash into the company. I caution everyone that the factors which have contributed to the current "crisis" are a condition that remains substantially unchanged from one year previous when we started with Speed Control. Some changes have occurred over the past year, but various additional fundamental changes need to be made before we really are proper in considering any contribution of additional cash to this company. Specifically,

> we need to review the management structure including, but not limited to, Mr. Barten. We must also review the course of engineering and productivity over the past year. At this point, we have a much clearer indication of both the management and engineering in this company and can make a much more intelligent and strategic analysis regarding this product and the potential of this company.

Levitt App., Ex. 43, App. p. 164.

On September 10, 1998, Seline was named Vice Chairman and General Counsel of Gold Circle Entertainment ("Gold Circle"). Gold Circle Entertainment is a company founded by Waitt in 1997 as "a full-service music-based enterprise." Levitt App., Ex. 44, App. at 165. Seline's responsibilities at Gold Circle included "evaluating various investment strategies, tax planning and overseeing company acquisitions." Levitt App. 44, App. at 165.

In September of 1998, Speed Control needed a new CEO and President, and requested that Levitt fill the position. Seline and Waitt thought it would be beneficial to have Waitt's representative on the Board of Directors, Levitt, fill the CEO and President positions at Speed Control. Seline and Waitt were of the opinion that any conflicts that might arise would be resolved by Levitt in Waitt's favor. On September 28, 1998, Levitt was appointed to serve as Speed Control's CEO and President. Seline signed the document, as Waitt's designee, appointing Levitt to be Speed Control's CEO and President. Levitt App., Ex. 12, App. at 71.

Levitt continued to monitor Speed Control's activities through December 1998. Waitt was satisfied with Levitt's performance up to this point. On December 11, 1998, Waitt executed a proxy which gave Levitt authority to vote Waitt's shares in Speed Control at a special shareholders meeting that was to be held on December 22, 1998. Levitt App., Ex. 47, App. at 172.

On December 23, 1998, Seline wrote to Levitt at Waitt's behest and relayed Waitt's

offer to grant Levitt an option to purchase 5% of Waitt's interest in Speed Control. On January 4, 1999, Speed Control sent Waitt a letter in which Speed Control sought to sell an additional 250,000 shares of Series B preferred stock in the company. Based on his current Speed Control stock holdings in the company, Waitt was offered an allocation of 65,270 shares of Series B preferred stock in Speed Control for the price of $130,540.

On January 13, 1999, Levitt sent to Seline a billing statement for six projects, including Speed Control, for the period of December 1, 1997, through December 31, 1998. Levitt App., Ex. 49, App. at 178. Levitt reduced from his billing $9,000 he had received from Speed Control for October, November, and December of 1998. Levitt App., Ex. 49, App. at 181.

On January 14, 1999, Levitt sent a letter to Seline in which he enclosed the minutes of both the shareholder's meeting and the board of director's meeting for December 22, 1998. The minutes for the board of director's meeting reveal that Speed Control's Board of Directors unanimously approved that Levitt's monthly compensation was to be $3,000 per month, retroactive to October 1, 1998. Levitt App., Ex. 50, App. at 184.

On January 29, 1999, Waitt invested an additional $130,540 in Speed Control and received 65,270 shares of Speed Control Series B preferred stock. On March 19, 1999, Levitt sent to Seline a copy of a "production loop" that was going to be implemented at Speed Control. Levitt App., Ex. 51, App. at 188. In April 1999, Waitt hired Matthew L. Rix to conduct an evaluation of Waitt's investments, including Speed Control. After being contacted by Rix, Levitt sent a note to Rix via facsimile on July 8, 1999. In this note, Levitt indicated that he would be sending certain updated documents requested by Rix to him on July 14, 1999.

On August 2, 1999, Levitt sent Rix via facsimile the proposed agenda for Speed Control's Board of Directors' meeting scheduled for August 9, 1999. Levitt App., Ex. 58, App. at 202. Rix attended the August 9, 1999, board of directors' meeting. Levitt App.,

Ex. 58, App. at 205. On August 9, 1999, a corporate white paper was issued by Speed Control to its Board of Directors. Levitt App., Ex. 59, App. at 209-225. A copy of this white paper was received by Waitt and filed as "Levitt Report for Norm Waitt." Levitt App., Ex. 60, App. at 337-38. The introduction to the white paper provides in pertinent part:

> Speed Control, Inc., a Washington State corporation, operates from its research and development facility in Kennewick, Washington. The company has been in development of a continuously variable transmission for application to bicycles since approximately 1992. Through the course of research and development, a design for manufacture on CNC equipment has emerged effective July 1999. Further, the company has assembled a spreadsheet detailing the costs of production under CNC Technology as information, enclosed in Exhibit B, to the board of directors. The current cost per unit, without burden of administrative and overhead costs, is approximately $500.00 for each transmission unit. The success to this point has been the actual development of a design and construction of a prototype that is capable of its stated use as a durable bicycle transmission. To be truly effective commercially as a product, the costs of the transmission must be reduced and the product delivery mode must be clearly defined. The mode must include a product system of all frame and ancillary parts that can be priced for market acceptance. The current view is that margin from a total bicycle system is necessary to achieve acceptable overall product margins. This is based upon the availability of the frame and ancillary parts as commodities from a full spectrum of U.S. suppliers or from offshore low-cost producers.

Levitt App., Ex. 59, App. at 210.

On August 18, 1999, Rix sent to Gold Circle Entertainment a confidential systems analysis of Speed Control that he had prepared. Levitt App., Ex. 62, App. at 340-44. Rix sent instructions that the report was to be provided to Waitt and Seline. Rix noted in his

report that:

> The current transmission units were available for demonstration prior to the board meeting. The units were mounted on bicycles using two different drive systems. One used the conventional chain drive, while the newer model used a belt drive, similar to the belt drive currently available on many motorcycles. The belt drive has many advantages over a chain drive system.
>
> Although one could shift up and down throughout the entire gearing ratio while pedaling the bicycles, it was very apparent that "up-shifting" (changing the gear ratio from a lower range to a higher range) was very difficult while pedaling. This problem could present a large obstacle to overall consumer acceptance, since it could be considered a design flaw or a negative aspect of the unit.
>
> However, when this issue was discussed with both Ned and Robert, they acknowledged the problem, and said that a current redesign with accompanying patents would remedy the problem. Changes to the unit should be completed within 60 to 90 days.
>
> Overall, the product concepts and designs are quite remarkable, and theoretically, could render the current chain drive, derailer, and shifter mechanisms obsolete. There are many potential spin-offs for this technology, including light-weight motor scooters (mopeds). If [Speed Control] decides to capitalize on the concept of "old product obsolensce", [Speed Control] could redefine the energy transfer systems for many high torque, low RPM vehicles.

Levitt App., Ex. 62, App. at 341-42.

Rix's report went on to contain the following conclusions:

> [Speed Control] has a very innovative bicycle transmission. Although the unit requires a few modifications to make it "consumer ready", it appears to be an innovation that has the potential to create a new paradigm within the bicycles industry. It is rare to find a product that has the ability to render current

> technology obsolete.
>
> However, for this to occur, I believe it is imperative for [Speed Control] to begin to view itself as a growing formal company, as opposed to just a small "start-up." Formal business systems must be put into place to help aid in consistency of products and processes. Formalized written procedures will help lay the foundation for future growth and decision making.
>
> Market positioning must be put into the forefront, since this will guide all other decisions concerning manufacturing and assembly, company structures, demand function matrixes, and variable cost curves. Market positioning must be conduced concurrent to final product development and quality system design.
>
> [Speed Control] needs to redirect its efforts away from engineering and CNC manufacturing. To accomplish this, I feel that a change in leadership is a priority. This will take a strong leader, one that has business management experience in manufacturing, intellectual property and technology management, and the creation of formalized quality systems. This leader must possess the ability to form strong cross-functional teams utilizing business sector specialists on an "as needed" basis.
>
> I feel that if a President and CEO with these assets can be found, [Speed Control] will be able to have a tremendous impact in the bicycle industry within the next few years.

Levitt App., Ex. 62, App. at 343.

On August 27, 1999, Robert Tomchuck, Speed Control's Executive Vice President wrote to Waitt to explain that a bicycle equipped with Speed Control's CVT transmission was being sent to him so that he could test ride the product. Levitt App., Ex. 64, App. at 354-356. Tomchuck noted recent developments in the CVT transmission as well as further modifications to the product that were needed:

Some background information relating to the recent development of the transmission mounted on this bicycle should be of interest to you. The [Speed Control] team was given a mission with three specific deliverables. It was directed to first, design and produce a 1st generation robust transmission that would operate for a minimum of 100 hours with virtually no breakage. Secondly, the transmission was to have a supporting controlled design drawing package that could be used for manufacturing the unit. The third deliverable was to obtain manufacturer's price quotations for piece parts in order to manufacture the transmission utilizing CNC machining technology. With limited resources, this effort commenced in January and was completed successfully in July, on schedule and within budget.

This transmission has many improvements over its predecessors. It is robust, operates quieter, is more efficient, and costs less than the model presented to the Board last September as the design for manufacture (DFM) transmission. However, this transmission is NOT the DFM transmission.

The time table and scope of work to develop the robust transmission was limited too, proving that a durable product could be constructed, that it could be manufactured, and determine a bench mark CNC cost to manufacture. One of the results of this process was the identification of three sub-assemblies where unique parts reduction could be realized. The lessor parts can be integrated with their interacting major or parent part. This integration produces fewer individual piece parts and significant cost reduction.

The [Speed Control] team has started the process that may include several iterations of design modification, production of shop drawings, machining parts, assembling, testing, disassembling and evaluating parts and transmission performance. After obtaining the desired results, the design will be frozen, and controlled engineering drawings produced, complete with parts specification. This model will be considered the second-generation robust design.

> The second-generation design can be used to manufacture transmissions in mass quantities employing the most practical and economical manufacturing process. This transmission design should be able to be produced at very competitive cost thus providing maximum profit margin.

Levitt App., Ex. 64, App. at 354-355. On August 30, 1999, Tomchuck shipped the bicycle via next day air to Waitt in care of Gold Circle Entertainment in Omaha, Nebraska.

On September 10, 1999, Levitt wrote to Waitt and Seline regarding questions raised about shifting the CVT transmission while under load. In his letter, Levitt noted that: This [Speed Control] development is ready to enter the final stages of preparation for mass production given its specifications as a first generation consumer product." Levitt App., Ex. 68, App. at 365. Levitt attached to his correspondence, a letter written by Ned Mills in engineering at Speed Control which addressed the question of the CVT's shifting characteristics. Levitt App., Ex. 68, App. at 367-69. Mills writes in pertinent part:

> The purpose of this letter is to provide the Board with information relating to a concern expressed in Mr. Rix's letter to Mr. Norm Waitt. The issue has to do with the current transmission design being able to shift up under load.
>
> . . . .
>
> The primary issues raised by these riders was <u>not</u> shifting, but were noise (23%) and pedal feel (16.8%). Having to stop pedaling to shift was only an issue to 9.4% of all riders. It is significant to note that in Mr. Rix's letter, he did not refer to either noise or pedal feel as an issue resulting from his riding the bike. This indicates the extent to which improvements (in response to the marketing study) have occurred in the past six months of development. Last year these two items were the most notable distractions to riding comfort.
>
> The study that included more than 300 riders was conducted with normal, average people, not athletes or mountain bikers. Most of the study riders did not consider the derailleur as a perfect system, and are waiting for the better

> system to come along. Therefore, this may explain the minimum concern reported over shifting up under load. It should be pointed out that our present shifter is greatly improved compared to the system used in the market study.
>
> . . .
>
> Now for the question, is it possible to improve the shifter function for our transmission so that it can be shifted more easily under load? The answer, like most engineering issues, is it can eventually be accomplished. How long it will take, or what the ultimate mechanical configuration will be is unknown at this time. We have already modeled more than 100 different shift mechanisms, and if there is a different solution waiting to be discovered that is more effective, only time will tell. As it is, if we want to refine what we now have by a half percentage point each time in three iterative attempts, that would by very encouraging. Frankly, I still consider this a refinement reserved not for the 1st generation design but for the 2nd generation product improvement.

Levitt App., Ex. 68, App. at 367-69.

On October 28, 1999, Waitt was sent the purchase agreement for the issuance of Preferred Class B stock in Speed Control. On November 10, 1999, Waitt invested $500,000 in Speed Control and received 250,000 shares of Preferred Class B stock in the company.

On December 3, 1999, Waitt wrote to Levitt and demanded the return of his $500,000 investment in Speed Control. Waitt's letter states in pertinent part:

> As you know, I have been frustrated by the progress Speed Control has made over the past three plus years since I invested. I would like to see the documentation or the status of the patents, which I now have been told, are in question as far as control and ownership. (Perhaps Ned Mills, an employee has control of the proper patents, not the company.) If there is any truth to this situation, I would find this appalling.
>
> In addition, I believe I've been mislead by Jerry and Jim as to the length of time needed to make the "company's??" product market ready. When I first invested, 3.5 years ago I was then

> told the product was very close to being ready for market. Unfortunately, this market ready date is still nowhere in sight from everything I hear. It was also interesting to learn very recently from you that Jerry and Jim have been involved in Speed Control for Eight years! I was never previously told they had been involved for this long. This is an **extremely** long time to make a product market ready in my opinion. Based on all these items and problems, I have come to regret any and all involvement with Speed Control, Inc. I am interested in selling all my previous investments in this company.
>
> Furthermore, please consider this letter to be a formal demand for the return of the $500,000 investment that I made one month ago.

Levitt App., Ex. 13, App. at 79 (emphasis original).

II. LEGAL ANALYSIS

A. Standards For Summary Judgment

This court has considered in some detail the standards applicable to motions for summary judgment pursuant to Federal Rule of Civil Procedure 56 in a number of prior decisions. *See, e.g., Swanson v. Van Otterloo*, 993 F. Supp. 1224, 1230-31 (N.D. Iowa 1998); *Dirks v. J.C. Robinson Seed Co.*, 980 F. Supp. 1303, 1305-07 (N.D. Iowa 1997); *Laird v. Stilwill*, 969 F. Supp. 1167, 1172-74 (N.D. Iowa 1997); *Rural Water Sys. #1 v. City of Sioux Ctr.*, 967 F. Supp. 1483, 1499-1501 (N.D. Iowa 1997), *aff'd in pertinent part*, 202 F.3d 1035 (8th Cir. 2000), *cert. denied*, 121 S. Ct. 61 (2000); *Tralon Corp. v. Cedarapids, Inc.*, 966 F. Supp. 812, 817-18 (N.D. Iowa 1997), *aff'd*, 205 F.3d 1347 (8th Cir. 2000) (Table op.); *Security State Bank v. Firstar Bank Milwaukee, N.A.*, 965 F. Supp. 1237, 1239-40 (N.D. Iowa 1997); *Lockhart v. Cedar Rapids Community Sch. Dist.*, 963 F. Supp. 805 (N.D. Iowa 1997). Thus, the court will not consider those standards in detail here. Suffice it to say that Rule 56 itself provides, in pertinent part, as follows:

> Rule 56. Summary Judgment
>
> (a) For Claimant. A party seeking to recover upon a claim, counterclaim, or cross-claim or to obtain a declaratory judgment may, at any time after the expiration of 20 days from the commencement of the action or after service of a motion for summary judgment by the adverse party, move with or without supporting affidavits for a summary judgment in the party's favor upon all or any part thereof.
>
> (b) For Defending Party. A party against whom a claim . . . is asserted . . . may, at any time, move for summary judgment in the party's favor as to all or any part thereof.
>
> (c) Motions and Proceedings Thereon. . . . *The judgment sought shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to judgment as a matter of law*.

FED. R. CIV. P. 56(a)-(c) (emphasis added). Applying these standards, the trial judge's function at the summary judgment stage of the proceedings is not to weigh the evidence and determine the truth of the matter, but to determine whether there are genuine issues for trial. *Quick v. Donaldson Co.*, 90 F.3d 1372, 1376-77 (8th Cir. 1996); *Johnson v. Enron Corp.*, 906 F.2d 1234, 1237 (8th Cir. 1990). An issue of material fact is genuine if it has a real basis in the record. *Hartnagel v. Norman*, 953 F.2d 394 (8th Cir. 1992) (citing *Matsushita Elec. Indus. Co. v. Zenith Radio Corp.*, 475 U.S. 574, 586-87 (1986)). As to whether a factual dispute is "material," the Supreme Court has explained, "Only disputes over facts that might affect the outcome of the suit under the governing law will properly preclude the entry of summary judgment." *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986); *Beyerbach v. Sears*, 49 F.3d 1324, 1326 (8th Cir. 1995); *Hartnagel*, 953 F.2d at 394. If a party fails to make a sufficient showing of an essential element of a claim with respect to which that party has the burden of proof, then the opposing party is "entitled to judgment as a matter of law." *Celotex Corp. v. Catrett*, 477 U.S. 317, 323 (1986)*; In re*

Temporomandibular Joint (TMJ) Implants Prod. Liab. Litig., 113 F.3d 1484, 1492 (8th Cir. 1997). In reviewing the record, the court must view all the facts in the light most favorable to the nonmoving party and give that party the benefit of all reasonable inferences that can be drawn from the facts. *See Matsushita Elec. Indus. Co.*, 475 U.S. at 587; *Quick*, 90 F.3d at 1377 (same). With these standards in mind, the court turns to consideration of defendants' respective motions for summary judgment.

B. Analysis Of Issues

Because of overlap in some of the issues raised in both defendants' motions, the court will proceed by addressing each of the individual issues raised in the motions *seriatim*.[2]

1. Spoilation of evidence

Both defendant Levitt and the Speed Control defendants seek summary judgment based on Waitt's alleged spoilation of evidence. Defendants assert that Waitt has failed

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[2]The parties apparently acquiesce that the court need not make a determination as to a choice of law in this case because there is no conflict between Iowa and California law on the issues raised by defendants' motions. The court agrees that there is no "true conflict" between the law of Iowa and the law of California as to the issues before the court on defendants' motions and therefore the court need not make a choice of law decision. *See Phillips v. Marist Soc'y*, 80 F.3d 274, 276 (8th Cir. 1996) ("[B]efore entangling itself in messy issues of conflict of laws a court ought to satisfy itself that there actually is a difference between the relevant laws of the different states."); *Nesladek v. Ford Motor Co.*, 46 F.3d 734, 736 (8th Cir. 1995) (first question was whether there was a "true conflict of laws," and where there was no doubt that case presented a "true conflict," court turned to consideration of which jurisdiction's law should apply under Minnesota conflict-of-laws rules); *Cleary v. News Corp.*, 30 F.3d 1255, 1265 (9th Cir. 1994) (court must first determine whether "true conflict" exists between the laws of the jurisdictions); *Harlan Feeders, Inc. v. Grand Labs., Inc.*, 881 F. Supp. 1400, 1405 (N.D. Iowa 1995) (noting that before any choice of law need be made, there must be a "true conflict" between the laws of the possible jurisdictions on the pertinent issue).

to produce a report prepared by Rix for Waitt regarding Speed Control. Defendants contend that the report was prepared between the time of Waitt's third and final investment in Speed Control and his December 3, 1999, letter demanding the return of his investment. Defendants argue that the circumstances surrounding the production of the report and Waitt's subsequent actions indicate that the report was a precipitating factor in Waitt's decision to demand the return of his investment in Speed Control. Defendants assert that Rix claims that the hard drive on his computer crashed and as a result the report was unsalvageable. Defendants claim that the report was sent to Waitt and Seline but that neither has produced the report. Defendants also contend that they are entitled to a presumption that the Rix report would be harmful to Waitt since he has been unable to produce it and therefore the court should grant them summary judgment due to Waitt's failure to produce the report. Defendants rely exclusively on the following deposition testimony of Rix in support their position:

> Q. And it appears in this e-mail to Steve Seline and Jacquie that your computer has crashed.
> A. Yes.
> Q. This would be your Gateway?
> A. Yes.
> Q. And then it says: I will try to recover the monthly report.
> Were you drafting monthly reports to Matt Rix regarding Speed Control?
> A. Not to Matt Rix.
> Q. I'm sorry to Steve Seline. I misspoke.
> A. Sporadically. It was not a --what I called a monthly report was just a status report. It was not given out monthly.
> Q. Are any of your monthly reports found in the materials that you have before you today?
> A. Not that I recall.
> Q. Where are your monthly reports?
> A. I lost them.

Q. How did you lose them?
A. When the computer crashed.
Q. Were they sent to Steve Seline in a hard form or in a – an e-mail or computer form?
A. Most likely they would have been e-mail.
Q. Now, do you know if there is a copy of these monthly reports anywhere?
A. I do not.
Q. Did you keep them on disk?
A. I kept them on hard drive.
Q. And is it your testimony that it was lost, the hard drive was lost on the laptop?
A. When the computer crashed, all data was lost.
Q. Did you have a zip drive or a backup on that?
A. No, not at the time.
Q. There's a reference to a report that you drafted in November of '99.
A. Okay.
Q. And we talked a little about it yesterday, and apparently it was a report that you drafted after Norm made his last $500,000 contribution but before December 3rd when Norm asked for the money back. Do you remember drafting some sort of report for Steve and Norm at that time?
A. Not specifically. I don't have clear knowledge or– or– I can't recall.
Q. Do you remember what you said in that report?
A. I can't recall.

Levitt App., Ex. 3, App. p. 31.

Waitt contends that Rix never prepared a report in November 1999, and that the only report prepared by Rix was the systems audit report done in August of 1999. Thus, Waitt asserts that there is no evidence of spoilation here. In support of his position, Waitt points out that defendants fail to site to the record where the "reference to a report" drafted in November of 1999, was previously made. Waitt also points to the following deposition testimony by Rix:

Q. Mr. Rix, in an e-mail you used the term "monthly report"; do you recall that?
A. Yes.
Q. What do you understand the term "monthly report" to mean in the context in which you used it in the e-mail?
A. A report can be any document that has specifics about a particular venture.
Q. Okay. Did you prepare any reports related to Speed Control?
A. Yes.
Q. Okay. How many reports do you recall preparing?
A. Only one.
Q. And what report is that?
A. That was the audit summary report.
Q. Okay. And, in fact, the audit summary report, the bottom portion of it, doesn't that, in fact, reference it as Speed Control report?
A. Yes.
Q. You're not aware of any other reports that you've done relative to Speed Control?
A. No.
Q. How many times did you visit Speed Control's offices?
A. Once.
Q. And was that one occasion in connection with the August report that you prepared?
A. Yes.
Q. If Seline was engaged in discussion with Mr. Huse regarding a report that you had done relative to Speed Control, would you assume that Seline was referencing your August report?
A. Yes, that would be the necessity.
Q. And in April 2000 when you were talking with Seline about a month report, what report would you have been talking to him about.
A. That same report, the one in August.

Waitt App., Ex. 104 at pp.88-89.[3]

A trial court has broad discretion to permit a jury to draw adverse inferences from a party's loss of evidence, or the destruction of evidence. *Sylla-Sawdon v. Uniroyal Goodrich Tire Co.*, 47 F.3d 277, 280 (8th Cir. 1995), *cert. denied,* 516 U.S. 822 (1995); *Vodusek v. Bayliner Marine Corp.*, 71 F.3d 148, 155-57 (4th Cir. 1995). Before imposing such a sanction, the court must determine whether the following three requirements were met: (1) The destruction of evidence prejudiced the opposing party; (2) the party against whom the sanction is sought had ownership or custody of the evidence when it was destroyed; and (3) the party against whom the sanction is sought knew or should have known that evidence would be relevant and should be preserved as evidence. *Id.* The spoliation doctrine also authorizes a court to order dismissal, to grant summary judgment, or permit an adverse inference to be drawn against a party, as a means to "level the evidentiary playing field and for the purpose of sanctioning improper conduct." *Vodusek*, 71 F.3d at 156. Application of the spoilation doctrine "must take into account the blameworthiness of the offending party and the prejudice suffered by the opposing party." *Anderson v. National R.R. Passenger Corp.*, 866 F. Supp. 937, 945 (E.D. Va. 1994), *aff'd*, 74 F.3d 1230 (4th Cir. 1996). Thus, absent bad-faith conduct on the part of a party in destroying evidence, dismissal on the grounds of spoilation of evidence is not authorized. *See Cole v. Keller Indus., Inc*, 132 F.3d 1044, 1047 (4th Cir. 1998) (noting that the remedy of dismissal was "simply too severe" in a case where the plaintiff, without bad faith, destroyed a ladder at issue in the case) (citing *Berthold-Jennings Lumber Co. v. St. Louis, I.M. & S. Ry. Co.*, 80 F.2d 32, 41-42 (8th Cir. 1935)); *Schmid v. Milwaukee Elec. Tool Corp.*, 13 F.3d 76, 78-81 (3d Cir. 1994) (reversing the district court's judgment for the defendant because the

[3]The court notes that Waitt's reference is to Rix's deposition given on December 27, 2001, while defendants refer to Rix's deposition given on November 2, 2001.

plaintiff did not intentionally destroy the evidence at issue). Mere negligence in losing or destroying records is not enough to warrant a sanction because it does not support an inference of consciousness of a weak case. *Vick v. Texas Employment Comm'n*, 514 F.2d 734, 737 (5th Cir. 1975).

Here, the court concludes that defendants have proffered no probative evidence which would demonstrate that Rix actually prepared a written report in November of 1999. From the court's reading of his deposition testimony, Rix did not acknowledge creating such a report. Rather, Rix clearly indicates that he created only one written, hard copy report, in August of 1999. Rix, however, does admit creating sporadic "monthly reports" which he e-mailed to Seline. Again, however, there is no probative evidence that Rix created such a monthly report in November of 1999. Other than that portion of Rix's deposition testimony cited by defendants, the court notes that defendants have not directed the court to any other part of the record where a reference to a report drafted by Rix in November of 1999, was made.

Moreover, even if the court was to assume *arguendo*, that Rix did prepare a monthly report in November of 1999, defendants have not demonstrated that Rix destroyed the report willfully or in bad faith. Indeed, the most defendants can demonstrate is that the putative report was lost due to negligence in not having retained a computer backup of the document. Rix's negligence in losing the putative monthly report is insufficient to warrant the sanction of granting summary judgment in defendants' favor because such action does not support an inference of consciousness of a weak case. *See Vick*, 514 F.2d at 737 (the sanction sought in *Vick*—application of the adverse inference rule—is not nearly as severe as that sought in this case). Therefore, this portion of defendants' respective motions for summary judgment is denied.

2. Fraud claims

Waitt asserts claims against all of the Speed Control defendants and Levitt for

fraudulent misrepresentation, fraudulent non-disclosure, and breach of warranty. Defendants assert that because Waitt cannot establish justifiable reliance his claims are barred as matter of law.[4] The court will briefly address the required elements for these claims and then turn to address whether defendants are entitled to summary judgment on any of these claims.

a. Required elements for fraud claims

As this court has explained on a number of occasions, "[t]he required elements of fraudulent misrepresentation under Iowa law are: (1) a material (2) false (3) representation coupled with (4) scienter and (5) intent to deceive, which the other party (6) relies upon with (7) resulting damages to the relying party." *Wright v. Brooke Group Ltd.*, 114 F. Supp.2d 797, 819 (N.D. Iowa 2000) (citing *Doe v. Hartz*, 52 F. Supp.2d 1027, 1055 (N.D. Iowa 1999) (internal quotations and citations omitted)); *Gunderson*, 85 F. Supp.2d at 922 (same); *Tralon Corp. v. Cedarapids*, Inc., 966 F. Supp. 812 (N.D. Iowa 1997) (same); *Jones Distrib. Co., Inc. v. White Consol. Indus., Inc.*, 943 F. Supp. 1445, 1473 (N.D. Iowa 1996) (same); *accord Gibson v. ITT Hartford Ins. Co.*, 621 N.W.2d 388, 400 (Iowa 2001) ("To establish a claim of fraudulent misrepresentation, a plaintiff must prove (1) defendant made a representation to the plaintiff, (2) the representation was false; (3) the representation was material, (4) the defendant knew the representation was false, (5) the defendant intended to deceive the plaintiff, (6) the plaintiff acted in reliance on the truth of the representation and was justified in relying on the representation, (7) the representation was a proximate cause of plaintiff's damages, and (8) the amount of damages."); *In re Marriage of Cutler*, 588 N.W.2d 425, 430 (Iowa 1999) (defining the elements of fraud as including (1) misrepresentation or failure to disclose when under a legal duty to do so, (2) materiality,

[4]Under Iowa law, fraudulent nondisclosure and fraudulent concealment are the same. Therefore, for purposes of these motions for summary judgment, the court will refer to fraudulent nondisclosure and fraudulent concealment interchangeably.

(3) scienter, (4) intent to deceive, (5) justifiable reliance, and (6) resulting injury or damage). The plaintiff must prove the elements of fraudulent misrepresentation by clear and convincing evidence. Id. at 820; *Cutler*, 588 N.W.2d at 430; *see also Ralfs v. Mowry*, 586 N.W.2d 369, 373 (Iowa 1998) (describing the burden as proving the existence of fraud "by clear, satisfactory, and convincing evidence") (citing *Benson v. Richardson*, 537 N.W.2d 748, 756 (Iowa 1995)).

Moreover, under Iowa law, [a] representation need not be an affirmative misstatement; the concealment of or failure to disclose a material fact can [also] constitute fraud. *Doe*, 52 F. Supp. 2d at 1055 (internal quotations and citations omitted). Iowa courts have recognized that "[a] misrepresentation may occur when one with superior knowledge, dealing with inexperienced persons who rely on him or her, purposely suppresses the truth respecting a material fact in the transaction." *Id.* (citing *Clark v. McDaniel*, 546 N.W. 2d 590, 592 (Iowa 1996)) (in a case involving fraudulent concealment in the sale of a car, the court stated, "for concealment to be actionable, the representation must relate to a material matter known to the party . . . which it is his legal duty to communicate to the other contracting party whether the duty arises from a relation of trust, from confidence, from inequality of condition and knowledge, or other attendant circumstances," and "[a] misrepresentation may occur when one with superior knowledge, dealing with inexperienced persons who rely on him or her, purposely suppresses the truth respecting a material fact in the transaction") (citations and internal quotations omitted). Thus, fraudulent nondisclosure and fraudulent concealment have the following elements:

> 1. Special circumstances existed which gave rise to a duty of disclosure between the plaintiff and the defendant. (Describe the relationship found to give rise to a duty of disclosure.)
>
> 2. While such relationship existed, the defendant [was aware of the following facts] [intended the following course of action] (state the facts or intent alleged to have been withheld).

> 3. While such relationship existed, the defendant concealed or failed to disclose [the knowledge or intent alleged to have been withheld].
>
> 4. The undisclosed information was material to the transaction.
>
> 5. The defendant knowingly failed to make the disclosure.
>
> 6. The defendant intended to deceive the plaintiff by withholding such information.
>
> 7. The plaintiff acted in reliance upon the defendant's failure to disclose and was justified in such reliance.
>
> 8. The failure to disclose was a proximate cause of the plaintiff's damage.
>
> 9. The nature and extent of the plaintiff's damage.

IOWA CIVIL JURY INSTRUCTIONS, 810.2; *see also Jones Distrib. Co.*, 943 F. Supp. at 1473; *Cutler*, 588 N.W. 2d at 430 (defining the elements of fraud as including (1) misrepresentation or failure to disclose when under a legal duty to do so, (2) materiality, (3) scienter, (4) intent to deceive, (5) justifiable reliance, and (6) resulting injury or damage). The plaintiff must prove the elements of fraudulent misrepresentation or fraudulent concealment by clear and convincing evidence. *Cutler*, 588 N.W. 2d at 430. As the Iowa Supreme Court has observed,

> [F]or concealment to be actionable, the representation must "relate to a material matter known to the party . . . which it is his legal duty to communicate to the other contracting party whether the duty arises from a relation of trust, from confidence, from inequality of condition and knowledge, or other attendant circumstances." *Sinnard* [*v. Roach*], 414 N.W. 2d [100,] 105 [(Iowa 1987)] (quoting *Wilden Clinic, Inc. v. City of Des Moines*, 229 N.W. 2d 286, 293 (Iowa 1975)).

Clark, 546 N.W. 2d at 592; *McGough v. Gabus*, 526 N.W. 2d 328, 331 (Iowa 1995) (fraud may arise from a special relationship giving rise to a duty to disclose and failure to make that disclosure). Iowa cases have not provided a specific test for determining when a duty

to reveal arises in fraud cases. *See Clark*, 546 N.W. 2d at 592 (citing *Sinnard,* 414 N.W. 2d at 106); *Arthur v. Brick*, 565 N.W. 2d 623, 625 (Iowa Ct. App.1997). However, Iowa courts have recognized that "[a] misrepresentation may occur when one with superior knowledge, dealing with inexperienced persons who rely on him or her, purposely suppresses the truth respecting a material fact in the transaction." *See Clark,* 546 N.W. 2d at 592 (quoting *Kunkle Water & Elec., Inc. v. City of Prescott*, 347 N.W. 2d 648, 653 (Iowa 1984)); *Arthur*, 565 N.W. 2d at 625 (quoting *Clark*); see also *Gouge*, 586 N.W. 2d at 714 (quoting *Arthur*).

Both fraudulent misrepresentation and fraudulent nondisclosure require reliance that is justified.[5] The Iowa Supreme Court has explained that:

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[5] Restatement (Second) of Torts § 537 provides that:

> The recipient of a fraudulent misrepresentation can recover against its maker for pecuniary loss resulting from it if, but only if,
> (a) he relies on the misrepresentation in acting or refraining from action, and
> (b) his reliance is justifiable.
>
> Comment:
>
> a. The recipient of a fraudulent misrepresentation can recover from the maker for his pecuniary loss only if he in fact relies upon the misrepresentation in acting or in refraining from action, and his reliance is a substantial factor in bringing about the loss (See § 546 and Comments). If the recipient does not in fact rely on the misrepresentation, the fact that he takes some action that would be consistent with his reliance on it and as a result suffers pecuniary loss, does not impose any liability upon the maker.
>
> b. The recipient must not only in fact rely upon the misrepresentation, but his reliance must be justifiable. The rules that determine whether he is justified in reliance upon

(continued…)

> Reliance is justified when a reasonably careful person would be justified in relying on the information supplied. Reliance is not justified if the person receiving the information knows or in the exercise of ordinary care should know that the information is false.

Pollmann v. Belle Plaine Livestock Auction, Inc., 567 N.W. 2d 405, 410 (Iowa 1997).

A plaintiff cannot recover if he "blindly relies on a misrepresentation the falsity of which would be patent to him if he had utilized his opportunity to make a cursory examination or investigation." *Lockard v. Carson*, 287 N.W. 2d 871, 878 (Iowa 1980); *accord* RESTATEMENT (SECOND) OF TORTS § 541 cmt. a (1977). Nevertheless, Iowa courts have refused to impose an objective standard of ordinary care on plaintiffs in fraud actions, stating:

> that the test for determining whether a party to a transaction has a right to rely on representations of the other is not whether a reasonably prudent person would be justified in relying on such representations but rather, whether the complaining party, in view of his own information and intelligence, had a right to rely on the representations. This subjective standard depends not on what an ordinarily prudent person reasonably would do to protect his or her interests, but upon what the complaining party reasonably could be expected to do.

Id. at 877.

Here, the Speed Control defendants have centered all of their arguments on whether Waitt can establish the justifiable reliance prong of his fraud claims. The court, therefore, will address this issue by examining each of Waitt's three investments in Speed Control in

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[5](…continued)

> various types of misrepresentations are stated in §§ 538 to 545 and in § 547.

RESTATEMENT (SECOND) OF TORTS § 537.

turn.

b. Justifiable reliance as to the first investment

The Speed control defendants argue that Waitt's reliance on their representations regarding Speed Control's CVT transmission was not justified. They point to several documents to support their argument. Specifically, the Speed Control defendants point to Waitt's letter of June 15, 1997, in which he noted his reluctance to get involved in venture capital deals. Levitt App., Ex. 9, App. p. 66. Furthermore, they cite to Levitt's letter of June 23, 1997, in which he analyzes Speed Control's business plan of November 1996. Levitt App., Ex. 28, App. pp. 134-140. In addition, the Speed Control defendants point to Waitt's July 29, 1997, letter to Seline and Levitt, in which Waitt noted his discussions with Huse and Bergland regarding "the positives and negatives" of Speed Control. Levitt App., Ex. 27, App. p. 107. The Speed Control defendants also direct the court's attention to Levitt's letter of August 29, 1997, to Seline in which Levitt commented on the Amended and Restated Articles of Incorporation and Investors Rights Agreement. Levitt App., Ex. 21. The Speed Control defendants further direct the court's attention to Levitt's letter of August 4, 1997, in which Levitt wrote to Seline and Waitt following his trip to Speed Control's headquarters in Washington and provided his observations of Speed Control. Speed Control App., Ex. 84, pp. 3-6. Moreover, the Speed Control defendants note the faxed note of August 6, 1997, from Levitt to Seline in which Levitt warned that Speed control was amassing debt at an alarming rate. Levitt App., Ex. 31, App. p. 144. Finally, the Speed Control defendants point to Levitt's letter of November 4, 1997, to Waitt and Seline in which Levitt reviewed the status of Waitt's participation in Speed Control. Speed Control App., Ex. 85, App. pp. 10-13.

The court concludes that the Speed Control defendants' submissions are insufficient, singularly or collectively, to enable this court to determine as a matter of law that Waitt's reliance on the representations made by the Speed Control defendants was unjustifiable.

It must be remembered that the determination of whether a plaintiff's reliance was justifiable is generally a question of fact for the jury to decide. *See Commercial Property Investments, Inc. V. Quality Inns Int'l. Inc.*, 938 F.2d 870, 876 (8th Cir. 1991) (noting that "the question of reliance is for the trier of fact, and thus should not be decided on summary judgment."); *see also Wolff v. Allstate Life Ins. Co.*, 985 F.2d 1524, 1531 (11th Cir. 1993) ("The determination of whether the plaintiff's reliance was justifiable is generally a question of fact for the jury to decide."); *accord West Shield Investigations & Security Consultants v. Superior Court*, 82 Cal. App. 4th 935, 957 (2000) ("Questions of materiality and justifiable reliance constitute questions of fact which cannot be resolved on summary adjudication, unless, in contrast to the present case, "the undisputed facts leave no room for a reasonable difference of opinion."); *Sims v. Tezak*, 296 Ill. App. 3d 503, 511, 694 N.E.2d 1015 (1998)(holding that "the justifiable reliance element of fraud is a question of fact" that is "to be determined by the finder of fact and not the by the trial court as a matter of law."); *Alliance Mortgage Co. v. Rothwell*, 900 P.2d 601, 608 (Cal. 1995) (noting that justifiable reliance is ordinarily a jury question but "may be decided as a matter of law if reasonable minds can come to only one conclusion based on the facts."); *Guido v. Koopman*, 1 Cal. App. 4th 832, 843 (1991) (" Justifiable reliance is an essential element of a claim for fraudulent misrepresentation, and the reasonableness of the reliance is ordinarily a question of fact."); *AT & T Information Systems, Inc. v. Cobb Pontiac-Cadillac, Inc.*, 553 So.2d 529, 532 (Ala. 1989) ("Whether reliance is justifiable in a given fraud action is a question of fact."); *Banes v. Cornerstone Inv., Inc.*, 773 P.2d 884, 886 (Wash. App. Ct. 1989) ("Generally, whether a party justifiably relied is a question of fact.").

The court's review of the materials submitted by the parties fails to establish as a matter of law that Waitt's asserted belief in the alleged representations made to him by the Speed Control defendants was unreasonable. For example, Waitt's reference to a "venture deal" in his letter of June 15, 1997, does not establish that Waitt was aware of the flaws

in Speed Control's CVT transmission or that the current state of its development was other than that represented to him. Similarly, Levitt's review of Speed Control's business plan does not establish that Waitt was aware of the CVT's current state of development. It is apparent that Levitt's review was limited to his examination of the business plan. A document that was over seven months old at the time of Levitt's report. Waitt could easily assume that the representations made to him in the summer of 1997 represented the true, current state of development of the CVT transmission. Moreover, Levitt's report is contradicted by his subsequent letter of August 4, 1997, when, after examining and viewing the CVT and discussing it with Mills and Barten, he wrote that: The CVT for a bicycle is operational & capable of production. The prototype is a success." Speed Control App., Ex. 84, App. pp. 6. Levitt's letter of November 4, 1997, is equally unavailing, since it post-dates Waitt's initial investment in Speed Control by a month. Therefore, the court does not believe it possible to conclude on the present record that reliance on the part of Waitt as to the first investment in Speed Control was unjustified in this case as a matter of law. Therefore, this portion of Speed Control's motion is denied.

c. Justifiable reliance as to the second investment

The Speed Control defendants assert that because Waitt was aware of the state of the CVT's development at the time of his second investment on January 29, 1999, he cannot claim that he reasonably relied on the alleged misrepresentations. The Speed Control defendants point out that Levitt, Waitt's advisor and attorney, was placed on Speed Control's Board of Directors on November 4, 1997, thereby making Waitt privy to all of the information regarding the engineering and progress of the CVT. Furthermore, the Speed Control defendants point out that Levitt was named President and CEO of Speed Control on September 28, 1998. In response, Waitt asserts that the Speed Control defendant's argument on this point is based on the false assumption that Levitt's knowledge may be imputed to Waitt due to Levitt's status as Waitt's attorney and representative. Waitt,

however, contends that due to Levitt's failure to provide Waitt with written disclosure of the conflict of interest in his occupying a board or officer position with Speed Control while at the same time continuing to represent Waitt's interest, and Levitt's failure to obtain a waiver of that conflict, Levitt's knowledge should not be imputed to Waitt. Moreover, Waitt argues that because the Speed Control defendants were parties to Levitt's breach of his fiduciary duties, they should not be allowed to gain from that conduct.

Ordinarily knowledge of an agent is imputed to the principal. *Mechanicsville Trust & Savs. Bank v. Hawkeye-Security Ins. Co.*, 158 N.W.2d 89, 91 (Iowa 1968); *Wyckoff v. A & J Home Benevolent Ass'n. of Creston*, 119 N.W.2d 126, 128 (1962); *Huff v. United Van Lines*, 28 N.W.2d 793, 799 (1947); *Hughes v. National Equip. Corp.*, 250 N.W. 154, 157 (1933); *see also Triple A Management Co. v. Frisone*, 69 Cal. App. 4th 520, 534-535, 81 Cal. Rptr. 2d 669 (1999); *Powell v. Goldsmith* 152 Cal. App. 3d 746, 750-751, 199 Cal. Rptr. 554 (1984); *Early v. Owens*, 109 Cal. App. 489, 494, 293 P. 136 (1930). In *Hughes*, the Iowa Supreme Court noted that:

> [I]t is a well settled general rule that a principal is affected with constructive knowledge, regardless of his actual knowledge, of all material facts of which his agent receives notice or acquires knowledge while acting in the course of his employment and within the scope of his authority, although the agent does not in fact inform his principal thereof.

Hughes, 250 N.W. at 157. The basis for imputing knowledge to the principal is that the agent has a legal duty to disclose information obtained in the course of the agency and material to the subject matter of the agency, and the agent will be presumed to have fulfilled this duty. *Contini v. Western Title Ins. Co.*, 40 Cal. App.3d 536, 547, 115 Cal. Rptr. 257 (1974); *Jaffe v. Heffner*, 173 Cal. App.2d 512, 518, 343 P.2d 374 (1959). This principle applies to an attorney-client relationship. *Herman v. Los Angeles County Metropolitian Trans. Authority*, 71 Cal. App. 4th 819, 827, 89 Cal. Rptr. 2d 144, 147 (1999)

(citing *Freeman v. Superior Court*, 44 Cal.2d 533, 537-538, 282 P.2d 857 (1955)).

Waitt, however, relies upon an exception to this general rule. As the Iowa Supreme Court has observed:

> An exception to imputation of notice from the agent to the principal is well recognized where the conduct and dealings of the agent clearly raise a presumption that he would not communicate the fact in controversy, as where such communication would necessarily prevent the consummation of a fraudulent scheme the agent was engaged in perpetrating.

Mechanicsville Trust & Savs. Bank, 158 N.W.2d at 91 (citing *Sherman v. Harbin*, 125 Iowa 100 N.W. 629, 633 (Iowa) and *Clapp v. Wallace*, 266 N.W. 493, 495 (Iowa)). Waitt argues that this exception is applicable here because Levitt violated his ethical obligations to Waitt and acted in his own self-interest. If as Waitt asserts, Levitt's interests were adverse to the interests of Waitt at the time his knowledge of the CVT was acquired, the adverse interest exception would prevent his knowledge from being imputed to Waitt. *Mechanicsville Trust & Savs. Bank*, 158 N.W.2d at 91. The court concludes that a material question of fact has been generated on the issue of whether Levitt's interests were aligned with the other Speed Control defendants in an adversarial relationship with Waitt at the time Waitt made his second investment in Speed Control. The court notes that the record is devoid of an explicit notification from Levitt to Waitt, after Levitt became a board member, correcting the misstatements in Speed Control's business plan. Moreover, the record is silent as to any notice Levitt supplied to Waitt concerning the engineering problems that Speed Control had experienced with the CVT's ball bearings, castings, and pawls. Therefore, for the purposes of the motions for summary judgment, the court concludes that the adverse interest exception prevents the imputation of Levitt's knowledge to Waitt. Absent such imputation, defendants cannot establish that Waitt's reliance was unjustified in this case as a matter of law. Therefore, this portion of the Speed Control defendants'

motion is also denied.

d. Justifiable reliance as to the third investment

With respect to Waitt's third investment in Speed Control, defendants point out that Waitt had obtained both Rix's systems analysis report in August of 1999, as well as Levitt's white paper in August of 1999. Thus, defendants argue that Waitt's reliance on their representations regarding Speed Control's CVT transmission was not justified. Rix noted in his report that:

> The current transmission units were available for demonstration prior to the board meeting. The units were mounted on bicycles using two different drive systems. One used the conventional chain drive, while the newer model used a belt drive, similar to the belt drive currently available on many motorcycles. The belt drive has many advantages over a chain drive system.
>
> Although one could shift up and down throughout the entire gearing ratio while pedaling the bicycles, it was very apparent that "up-shifting" (changing the gear ratio from a lower range to a higher range) was very difficult while pedaling. This problem could present a large obstacle to overall consumer acceptance, since it could be considered a design flaw or a negative aspect of the unit.
>
> However, when this issue was discussed with both Ned and Robert, they acknowledged the problem, and said that a current redesign with accompanying patents would remedy the problem. Changes to the unit should be completed within 60 to 90 days.

Levitt App., Ex. 62, App. at 341-42. While Rix's report does point out design problems that he experienced with the CVT, it also indicates that those design problems would be rectified in 60 to 90 days. Moreover, because Rix is not an engineer, his systems analysis was directed more to the management and structure of the company, and not to an independent evaluation of the CVT's technology. While Levitt's white paper purported to

detail Speed Control's development, it contained a number of questionable statements regarding the state of the CVT's development. For instance, the White Paper states that Speed Control had "a design and construction of a prototype that is capable of its stated use as a durable bicycle transmission." Levitt App., Ex. 59, App. at 210. In addition, Levitt notes in the white paper that the "current Mills design can be manufactured and used by the consumer in a reliable fashion." Levitt App., Ex. 59, App. at 210. Thus, the court concludes that a material fact question has been generated as to whether Waitt's reliance was justified at the time of his third investment. Therefore, this portion of the Speed Control defendants' motion is also denied.

3. Pleading fraud with requisite specificity

The Speed Control defendants also assert that Waitt has failed to meet the pleading particularity requirements of Federal Rule of Civil Procedure 9(b) with respect to his allegations of fraud contained in paragraphs 14 and 15 of his complaint.[6]

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[6]Waitt alleges in paragraphs 14 and 15 of his complaint that:

> 14. During the period of July 1997 though 2000, defendants all made oral representations and statements to Plaintiff, or Plaintiff's representatives, concerning the market readiness of the product and its manufacturability. Defendants repeatedly asserted that the CVT system either was or would be ready for mass manufacturing with infusion of capital by the Plaintiff. These statements were false and misleading in so far as the company did not have and still does not have a product which is manufacturable in mass quantities or ready for market distribution and sale.
>
> 15. In a meeting in February 2000, Defendants Huse and Bergland advised Plaintiff that there were questions as to the ownership of key patents of the company, and that

(continued…)

This court has articulated the standards for pleading fraud with the particularity required by Rule 9(b) of the Federal Rules of Civil Procedure in several decisions.[7] *See Iowa Health Sys. v. Trinity Health Corp.*, 177 F. Supp. 2d 897, 916 (N.D. Iowa 2001); *Wright v. Brooke Group, Ltd.*, 114 F. Supp. 2d 797, 832-33 (N.D. Iowa 2000); *Gunderson v. ADM Investor Serv., Inc.*, 85 F. Supp. 2d 892, 903 (N.D. Iowa 2000); *Doe v. Hartz*, 52 F. Supp. 2d 1027, 1055 (N.D. Iowa 1999); *Brown v. North Cent. F.S., Inc.*, 987 F. Supp.

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[6](…continued)

> there were concerns about the company's chief engineer's competence, the engineering data which he assembled, and the recommendations he made, all of which would require additional engineering analysis, prior to having a manufacturable or market ready product. Defendants were in a position to make said assessments prior to investments by Plaintiff in Speed Control in January and November of 1999. Despite the opportunity to issue corrective statements, which would have caused Plaintiff to defer additional investment in the company, defendants' failed to issue statements correcting the prior material representations including those relative to the manufacturability of the product, the market readiness of the product, the competence of the company's engineers, and the validity of company patents.

Complaint at ¶¶ 14-15.

[7]Rule 9(b) of the Federal Rules of Civil Procedure provides as follows:

> **(b) Fraud, Mistake, Condition of the Mind.** In all averments of fraud or mistake, the circumstances constituting the fraud or mistake shall be stated with particularity. Malice, intent, knowledge, and other condition of mind of a person may be averred generally.

FED. R. CIV. P. 9(b).

1150, 1155-57 (N.D. Iowa 1997); *Brown v. North Cent.*, 173 F.R.D. 658, 664-65 (N.D. Iowa 1997); *North Cent. F.S., Inc. v. Brown*, 951 F. Supp. 1383, 1407-08 (N.D. Iowa 1996); *DeWit v. Firstar Corp.*, 879 F. Supp. 947, 970 (N.D. Iowa 1995). In *Wright*, this court provided the following brief discussion of these matters:

> Rule 9(b) of the Federal Rules of Civil Procedure "'requires a plaintiff to allege with particularity the facts constituting the fraud.'" *See Brown*, 987 F. Supp. at 1155 (quoting *Independent Business Forms v. A-M Graphics*, 127 F.3d 698, 703 n.2 (8th Cir. 1997)). "'When pleading fraud, a plaintiff cannot simply make conclusory allegations.'" *Id.* (quoting *Roberts v. Francis*, 128 F.3d 647, 651 (8th Cir. 1997)). In *Commercial Property Inv., Inc. v. Quality Inns Int'l, Inc.*, 61 F.3d 639 (8th Cir. 1995), the Eighth Circuit Court of Appeals explained:
>
> > Rule 9(b) requires that "[i]n all averments of fraud or mistake, the circumstances constituting fraud or mistake shall be stated with particularity." "'Circumstances' include such matters as the time, place and content of false representations, as well as the identity of the person making the misrepresentation and what was obtained or given up thereby." *Bennett v. Berg*, 685 F.2d 1053, 1062 (8th Cir. 1982), *adhered to on reh'g*, 710 F.2d 1361 (8th Cir.), *cert. denied*, 464 U.S. 1008, 104 S. Ct. 527, 78 L. Ed. 2d 710 (1983). Because one of the main purposes of the rule is to facilitate a defendant's ability to respond and to prepare a defense to charges of fraud, *Greenwood v. Dittmer*, 776 F.2d 785, 789 (8th Cir. 1985), conclusory allegations that a defendant's conduct was fraudulent and deceptive are not sufficient to satisfy the rule. *In re Flight Transp. Corp. Sec. Litig.*, 593 F. Supp. 612, 620 (D. Minn. 1984).
>
> *Commercial Property*, 61 F.3d at 644; *see Roberts*, 128 F.3d at 651 (noting that factors a court should examine in determining whether the "circumstances" constituting fraud are stated with particularity under Rule 9(b) "include the time, place, and contents of the alleged fraud; the identity of the person allegedly committing fraud; and what was given up or obtained

by the alleged fraud.").

Wright, 114 F. Supp. 2d at 832-33.

In each of this court's prior decisions discussing the requirements of Rule 9(b), the matter was before the court on a motion to dismiss. This is because a challenge based on Rule 9(b) is usually brought at the beginning of a case via a motion to dismiss.[8] Such a challenge, where successful, facilitates a defendant's ability to respond and to prepare a defense to charges of fraud and thus serves one of the main purposes of the rule. *See Greenwood*, 776 F.2d at 789. Moreover, a plaintiff is usually permitted to amend the complaint to replead fraud with particularity. *Burlington Coat Factory Secs. Litig.*, 114 F.3d 1410, 1435 (3rd Cir. 1997) ("Ordinarily where a complaint is dismissed on Rule 9(b) 'failure to plead with particularity' grounds alone, leave to amend is granted."); *Shapiro v. UJB Fin. Corp.*, 964 F.2d 272, 284-85 (3rd Cir. 1992) ("Ordinarily, such claims are dismissed with leave to amend."); *Luce v. Edelstein*, 802 F.2d 49, 56-57 (2nd Cir. 1986) (noting that "Complaints dismissed under Rule 9(b) are 'almost always' dismissed with leave to amend."). Nonetheless, "[a] district court may enter summary judgment dismissing a complaint alleging fraud if the complaint fails to satisfy the requirements of Rule 9(b)." *Murr Plumbing, Inc. v. Scherer Bros. Fin. Servs. Co.*, 48 F.3d 1066, 1070 (8th Cir. 1995).

In general, allegedly fraudulent statements must be linked to individual speakers; vague references to "defendants" as the speakers are insufficient. *Mills v. Polar Molecular Corporation*, 12 F.3d 1170, 1175 (2d Cir. 1993); *accord Luce*, 802 F.2d at 54. However, this is precisely what Waitt does in paragraph 14 of his complaint. In paragraph 14, Waitt

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[8] Here, the Speed Control defendants did not move for a more definite statement, pursuant to Federal Rule of Civil Procedure 12(e), before answering the complaint. Nor did the Speed Control defendants seek dismissal of the claims contained in paragraphs 14 and 15 of the complaint based on Rule 9(b).

does not identify any specific statement made by any specific defendant during a three year period of time. The vague and general allegations contained in paragraph 14 fail to satisfy Rule 9(b)'s particularity requirement.

The Speed Control defendants challenge the sufficiency of the fraud allegations contained in paragraph 15 on the ground that conclusory allegations of scienter are insufficient. With respect to the adequacy of the pleading of scienter in light of the requirements imposed by Rule 9(b), this court has held that

> "general averments of the defendants' knowledge of material falsity will not suffice. Consistent with Fed. R. Civ. P.. 9(b), the complaint must set forth specific facts that make it reasonable to believe that defendant[s] knew that a statement was materially false or misleading."

Brown v. North Cent. F.S., Inc., 173 F.R.D. 658, 669 (N.D. Iowa 1997) (quoting *Lucia v. Prospect Street High Income Portfolio, Inc.*, 36 F.3d 170, 174 (1st Cir. 1994), in turn quoting *Serabian v. Amoskeag Bank Shares, Inc.*, 24 F.3d 357, 361 (1st Cir. 1994)); *Brown v. North Cent. F.S., Inc.*, 951 F. Supp. at 1408 (quoting *DeWit v. Firstar Corp.*, 879 F. Supp. 947, 989-90 (N.D. Iowa 1995)). Here, the court concludes that Waitt has failed to set forth in his complaint specific facts that make it reasonable to believe that defendants Huse and Berglund knew that their statements were materially false or misleading. *See Lucia*, 36 F.3d at 174 (quoting *Serabian*, 24 F.3d at 361); *see also North Central F.S., Inc.*, 951 F. Supp. at 1408 (quoting *DeWit*, 879 F. Supp. at 989-90, in turn quoting *Lucia*, 36 F.3d at 174). Rather than state specific facts supporting scienter, paragraph 15 contains only the conclusory statement that "Defendants were in a position to make said assessments prior to investments by Plaintiff in Speed Control in January and November of 1999." Complaint at ¶ 15. Therefore, the court concludes that paragraph 15 of the complaint does not allege with particularity defendant Huse and Berglund's knowledge or notice of falsity. Thus, this portion of the Speed Control defendant's motion for summary judgment is granted.

Waitt has requested leave to replead. As noted above, complaints dismissed under Rule 9(b) are almost always dismissed with leave to amend. *See Burlington Coat Factory Secs. Litig.*, 114 F.3d at 1435; *Shapiro,* 964 F.2d at 284-85; *Luce*, 802 F.2d at 56-57. In cases where such leave has not been granted, plaintiffs have usually already had one opportunity to plead fraud with greater specificity. *Luce*, 802 F.2d at 56-57. Indeed, in *Caputo v. Pfizer*, 267 F.3d 181, 191 (2nd Cir. 2001), the Second Circuit Court of Appeals held that a district court abused its discretion in not permitting the plaintiff in that case to amend his complaint where the defendant never moved to dismiss on Rule 9(b) grounds, moved for summary judgment on Rule 9(b) grounds only after the close of discovery, and amendment of the complaint would not be futile. *Id.* Here, justice requires that leave to amend be granted in this case. Waitt has made no prior application for leave to amend, and the court cannot say that an effort to replead would be futile. Therefore, the court will grant Waitt's request for leave to replead the claims contained in paragraphs 14 and 15 of his Speed Control complaint.

4. Breach of duty and negligence claims

The court will address Waitt's claims against Levitt for breach of fiduciary duty and/or negligence by examining each of Waitt's three investments in Speed Control in turn. However, before doing so, the court will briefly examine the required elements for claims of breach of fiduciary duty and negligence.

a. Required elements for negligence and breach of fiduciary duty claims

i. Negligence

The elements for a cause of action for negligence are:

> (1) the existence of a duty to conform to a standard of conduct for the protection of others; (2) failure to conform to that standard; (3) a reasonably close causal connection . . . and (4) damages.

Smith ex rel. Estate of Smith v. Shaffer, 395 N.W.2d 853, 855 (Iowa 1986) (*en banc*);

Bockelman v. State, 366 N.W.2d 550, 552 (Iowa 1985); *Haafke v. Mitchell*, 347 N.W.2d 381, 385 (Iowa 1984). Negligence is generally defined as conduct that falls below the standard established by law for the protection of others against unreasonable risk of harm. *Knake v. King*, 492 N.W.2d 416, 417 (Iowa 1992); *Peters v. Burlington Northern R.R. Co.*, 492 N.W.2d 399, 401 (Iowa 1992) ("Negligence is the breach of a legal duty or obligation."); *Shaffer*, 395 N.W.2d at 855; *M.H. v. State*, 385 N.W.2d 533, 537 (Iowa 1986); *Seeman v. Liberty Mut. Ins. Co.*, 322 N.W.2d 35, 37 (Iowa 1982).

The threshold element for a negligence action is a duty or standard of care owed by the actor to the victim. *Knake*, 492 N.W.2d at 417; *Peters*, 492 N.W.2d at 401; *Shaw v. Soo Line R.R.*, 463 N.W.2d 51, 53 (Iowa 1990). A particular relationship between the actor and victim is not an absolute requirement in establishing a legal duty or standard of due care, especially when the consequences of a negligent act cause harm to another. *Knake*, 492 N.W.2d at 417; *Keller v. State*, 475 N.W.2d 174, 179 (Iowa 1991). Generally, the issue of duty in a negligence cause of action is whether the defendant acted as would a reasonably careful person under like circumstances. *Knake*, 492 N.W.2d at 417; *Brichacek v. Hiskey*, 401 N.W.2d 44, 47 (Iowa 1987). The question of whether a party's conduct is reasonable is usually one of fact rather than one of law. *Knake*, 492 N.W.2d at 417.

It is well established that an attorney-client relationship may give rise to a duty, the breach of which may be legal malpractice. In a lawyer malpractice case, the plaintiff must demonstrate:

> (1) the existence of an attorney-client relationship giving rise to a duty, (2) the attorney, either by an act or failure to act, violated or breached that duty, (3) the attorney's breach of duty proximately caused injury to the client, and (4) the client sustained actual injury, loss, or damage.

Ruden v. Jenk, 543 N.W.2d 605, 610 (Iowa 1996); *see Vande Kop v. McGill*, 528 N.W.2d 609, 613 (Iowa 1995); *Schmitz v. Crotty*, 528 N.W.2d 112, 115 (Iowa 1995); *Dessel v.*

Dessel, 431 N.W.2d 359, 361 (Iowa 1988); *Burke v. Roberson*, 417 N.W.2d 209, 211 (Iowa 1987); *see also Kubik v. Burk*, 540 N.W.2d 60, 63 (Iowa Ct. App. 1995); *Benton v. Nelson*, 502 N.W.2d 288, 291 (Iowa Ct. App. 1993).

Causation is another essential element in a negligence action. *Mulcahy v. Eli Lilly & Co.*, 386 N.W.2d 67, 72 (Iowa 1986); *Iowa Electric Light & Power Co. v. General Electric Co.*, 352 N.W.2d 231, 234 (Iowa 1984). The causation requirement entails proof of a "causal connection between the defendant's alleged negligence and the injury." *Mulcahy*, 386 N.W.2d at 72; *Sponsler v. Clarke Elec. Coop., Inc.*, 329 N.W.2d 663, 665 (Iowa 1983). "'Causation goes to the question of what instrumentality or mechanism caused plaintiff's injury.'" *Mulcahy*, 386 N.W.2d at 72 (quoting *McElhaney v. Eli Lilly & Co.*, 564 F. Supp. 265, 268 (D.S.D. 1983)). The Iowa Court of Appeals has made the following observations about the causation element of a negligence cause of action under Iowa law:

> Causation is a necessary element in all negligence cases. It is actually composed of two related but separate concepts. The first considers the actual cause of the harm. This is known as "cause-in-fact." The second part embraces the legal cause of the injury. This is known as "proximate cause." Even though an act of the defendant may be the factual or actual cause of the plaintiff's injury, liability will only be imposed if it is also a proximate or legal cause of the injury.
>
> The test to determine the actual cause prong of causation is known as sine qua non; but for the defendant's conduct, the harm would not have occurred. *State v. Marti*, 290 N.W.2d [570] at 585 [(Iowa 1980)]. The test to determine proximate or legal cause is more involved. Generally, an actor's conduct is a proximate or legal cause of harm to another if the conduct is a "substantial factor" in producing the harm and there is no other rule of law which relieves the actor of liability because of the manner in which the negligence resulted in the harm. *Kelly v. Sinclair Oil* Corp., 476 N.W.2d [341] at 349 [(Iowa 1991)]. Iowa follows the Restatement (Second) of Torts in using the "substantial factor" test to help determine the

> existence of proximate or legal cause. *Id.*; *Frederick v. Goff*, 251 Iowa 290, 298, 100 N.W.2d 624, 629 (1960). This test is found in uniform instruction 700.3, together with the "but for" test.

Sumpter v. City of Moulton, 519 N.W.2d 427, 434 (Iowa App.1994); *see Jones v. City of Des Moines*, 355 N.W.2d 49 (Iowa 1984) (defining proximate cause as the substantial factor and but for cause).

Thus, the causation element of a negligence cause of action requires proof that defendant's conduct was a substantial factor in bringing about plaintiff's harm before defendant's conduct can be found to be a proximate cause of that harm. *Shaffer*, 395 N.W.2d at 857; *Iowa Electric*, 352 N.W.2d at 234; *Sumpter*, 519 N.W.2d at 434. If an actor's conduct is not a substantial factor in bringing about the plaintiff's harm, or if it is a substantial factor but is superseded by later forces or conduct, then the actor's conduct does not constitute the legal cause of the plaintiff's harm. *Shaffer*, 395 N.W.2d at 857; *Schnebly v. Baker*, 217 N.W.2d 708, 729 (Iowa 1974). There can be more than one proximate cause to a plaintiff's injuries. *Welte v. Bello*, 482 N.W.2d 437, 442 (Iowa 1992).

The negligence of a professional must ordinarily be shown by expert testimony. *Forsmark v. State*, 349 N.W.2d 763, 768 (Iowa 1984). However, under Iowa law, it is not necessary to present expert testimony to prove breach of a professional standard of care if negligence can be recognized with the common experience and knowledge of lay persons. *See, e.g., Welte*, 482 N.W.2d at 441 (no expert testimony required for jury to decide whether doctor breached professional standard of care by injecting incorrect medication resulting in chemical burns); *Oswald v. LeGrand*, 453 N.W.2d 634, 639-40 (Iowa 1990) (no expert required in medical malpractice case for poor patient relations); *Devine v. Wilson*, 373 N.W.2d 155, 157 (Iowa Ct. App. 1985) (no expert required in suit against attorney for breach of duty of professional care).

ii. Breach of fiduciary duty

Like a negligence claim, a claim for breach of fiduciary duty has four required elements: (1) the existence of a fiduciary relationship between the parties, (2) a breach of that fiduciary duty, (3) causation, and (4) harm or damage. *City of Atascadero v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 68 Cal. App. 4th 445, 483, 80 Cal. Rptr. 2d 329 (1998); *Mosher v. Southern Cal. Physicians Ins. Exchange*, 63 Cal. App. 4th 1022, 1044, 74 Cal. Rptr.2d 550 (1998); *Stanley v. Richmond*, 35 Cal. App. 4th 1070, 1086, 41 Cal. Rptr.2d 768 (1995).

As this court observed in *Oeltjenbrun v. CSA Investors, Inc.*, 3 F. Supp. 2d 1024 (N.D. Iowa 1998), the Iowa Supreme Court has defined a fiduciary relationship in the following manner:

> "A fiduciary relationship exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relationship." *Kurth v. Van Horn*, 380 N.W.2d 693, 695 (Iowa 1986) (citing Restatement (Second) of Torts § 874 cmt. a (1979)). We have also noted that
>
> > a confidential relationship "exists when one person has gained the confidence of another and purports to act or advise with the other's interest in mind. . . . The gist of the doctrine of confidential relationship is the presence of a dominant influence under which the act is presumed to have been done. [The] [p]urpose of the doctrine is to defeat and protect betrayals of trust and abuses of confidence."
>
> *Hoffman v. National Med. Enters., Inc.*, 442 N.W.2d 123, 125 (Iowa 1989) (quoting *Oehler v. Hoffman*, 253 Iowa 631, 635, 113 N.W.2d 254, 256 (1962)) . . . .
>
> . . . .[W]e are cognizant of the fact that "[b]ecause the circumstances giving rise to a fiduciary duty are so diverse, any such relationship must be evaluated on the facts and circumstances of each individual case." *Kurth*, 380 N.W.2d at 696.

Oeltjenbrun, 3 F. Supp. 2d at 1053 (quoting *Wilson v. IBP, Inc.*, 558 N.W.2d 132, 138 (Iowa 1996), *cert. denied*, 522 U.S. 810 (1997)); *see also Economy Roofing & Insulating Co. v. Zumaris*, 538 N.W.2d 641, 647-48 (Iowa 1995) (also recounting indicia of a fiduciary relationship); *Anderson v. Boeke*, 491 N.W.2d 182, 188 (Iowa Ct. App. 1992) ("'A fiduciary relationship exists between two persons when one of them is under a duty to act for or to give advice for the benefit of another upon matters within the scope of the relation,'" quoting *Kurth*, 380 N.W.2d at 695, in turn quoting RESTATEMENT (SECOND) OF TORTS § 874 cmt. a).

Courts have recognized that fiduciary relationships exist between attorneys and their clients. *See Economy Roofing & Insulating Co. v. Zumaris*, 538 N.W.2d 641, 647 (Iowa 1995); *Kurth*, 380 N.W.2d at 695; *Pierce v. Lyman*, 1 Cal. App. 4th 1083, 1101, 3 Cal. Rptr. 2d 236, 240 (1991); *Barbara A. v. John G.*, 145 Cal. App. 3d 369, 382, 193 Cal. Rptr. 422, 431 (1983); *Wagner v. Wagner*, 45 N.W.2d 508, 509 (Iowa 1951); *see also Irons v. Community State Bank*, 461 N.W.2d 849, 851 (Iowa Ct. App. 1990) (quoting *Kurth*, 380 N.W.2d at 695).

b. Waitt's first investment

With respect to his first investment in Speed Control, Waitt asserts claims against Levitt for breach of fiduciary duty and/or negligence. Waitt asserts that Levitt was unaware of the conditions that existed at Speed Control due to Levitt's failure to exercise the proper standard of care. Waitt also asserts that Levitt violated his duty to avoid conflicts of interest in the period leading up to Waitt's first investment in Speed Control and that this conflict led Waitt losing his first investment in Speed Control. In his motion for summary judgment, Levitt asserts the following defenses against Waitt's claims against him with respect to Waitt's first investment: that Waitt requested that all communications be conducted through Seline because Seline was the main legal person with respect to the Speed Control investment; that Levitt provided information to Seline; that Waitt and Seline

came to understand Speed Control through Levitt's work product; that Waitt and Seline knew that the CVT was not perfected; that Waitt and Seline ended the due diligence period; that Waitt did not complaint about Levitt's performance, and that Waitt was not injured by Levitt's performance relative to the first investment. The court will address each of these arguments *seriatim*.

i. Communication through Seline

In his motion for summary judgment, Levitt initially asserts that Waitt requested that all communications be conducted through Seline and that Seline was the main legal person with respect to the Speed Control investment and he was to take his instructions from Seline. In response, Waitt notes that despite this claim, Levitt had direct communications with him through 1998 and 1999. Waitt also notes that the only evidence put forward by Levitt in support of his claim that he was not to act unless instructed by Waitt or Seline is Levitt's faxed note to Seline on July 15, 1997, in which Levitt notes that he will be in Kennewick, Washington in the future but would avoid making contact with Ned Mills unless "specifically requested." Levitt App., Ex. 16, App. P. 85. With respect to Levitt's claim that he was instructed that Seline was the main legal person on the Speed Control investment, Waitt notes that the only evidence put forward by Levitt is a hand written, illegible note made by Levitt which is inadmissible hearsay. Levitt App., Ex. 17, App. p. 86. Waitt also points to deposition testimony of Seline in which Seline testified that Levitt was the "primary" person conducting due diligence on Speed Control and Levitt was responsible for letters related to due diligence. Waitt App., Ex. 105, p. 328. Given the limited, cryptic, and conflicting evidence on this point, the court concludes that a genuine issues of material fact exists as to the issue of whether Levitt was directed to communicate through Seline, that Seline was the main legal person with respect to the Speed Control investment, that Levitt was ordered to take his instructions from Seline. Therefore, summary judgment is denied on this argument.

ii. Levitt provided information to Seline

Levitt also argues that he provided information to Seline. This contention is but a variation on the argument Levitt's first argument that Seline was in control of the Speed Control investment investigation and that Levitt was merely following the direction of Seline. However, given Waitt's deposition testimony that he delegated the Speed Control investment investigation to Levitt, see Waitt App., Ex. 92, p. 70, the court concludes that a genuine issues of material fact exists as to the issue of whether Levitt was in control of the Speed Control investment investigation. Therefore, summary judgment is denied on this argument.

iii. Waitt came to understand Speed Control through Levitt's work

Levitt next suggests that Waitt and Seline came to understand Speed Control through Levitt's work product. It is clear that Levitt did supply information to both Seline and Waitt regarding the status of Speed Control. While Levitt directs the court's attention to a number of documents prepared by him prior to August 4, 1997, on August 4, 1997, however, Levitt wrote to Seline and Waitt following his trip to Speed Control's headquarters in Washington and reported that:

> 1. I rode the bicycle under various conditions. I was told that this was an upgraded version of the bicycle that Norm rode.
>
> I learned that:
>
> a. The CVT for a bicycle is operable & capable of production. The prototype is a success.
>
> b. Speed Control, Inc. (SCI) does not clearly articulate these matters and poorly presents facts. No evidence appears that this with malice or manipulation, rather, this is an inadequacy within SCI. Ned Mills is an inventor, not an engineer. Mr. Barton is not an effective communicator in this area. Together, neither has been

> able to articulate the course of development nor the current stage in development. However, from my questions & inspections, I have learned much which was previously obscure.
>
> . . .
>
> 3. Production techniques and final materials are not specified, not even approximated! B.S.! Mills himself knows that this process must go step-by-step with small, but constant improvement. [Speed Control] is not on this track & must get there soon. Mills & Levitt connected on the feedback loop necessary for human factor testing, material & construction specifications, etc.

Speed Control App., Ex. 84, App. pp. 3, 6. Levitt went on to offer his impressions of Speed Control:

> 1. This company is in need of a management reorganization to a degree. Several good pieces are in place, but the knitting needs to be more complete and tighter. Mr. Mills is awesome. The product is prototyped. Offices and short term production are close to ready. Need production engineering, real product development plans, and real sales, accounting and support staff. This is all very possible, in the short term. <u>But</u>, you should not consider this a mere investment. They need capital <u>both</u> because the development is not yet complete in terms of the company as a whole, but also because the current management/direction is inadequate and underperforming in my view.
>
> This is worth an investment because Mills & the products are awesome and easy to comprehend, engage, and establish both and entry and exit strategy.

Speed Control App., Ex. 84, App. pp. 7.

Levitt's conclusions regarding the developmental status of the CVT and how close to production Speed Control was at the time proved to be incorrect. Levitt does not direct

the court to any admissible evidence in the record that Levitt ever retracted, modified or otherwise corrected the conclusions contained in his August 4, 1997, letter to Seline and Waitt. On the record before it, the court conclude that a material question of fact has been generated as to whether, prior to Waitt's first investment in Speed Control, Levitt supplied Waitt and Seline with accurate information regarding Speed Control and the CVT transmission. Therefore, summary judgment is also denied as to this argument.

iv. Waitt knew that the CVT was not perfected

Levitt also argues that Waitt, prior to his first investment in Speed Control, knew that the CVT was not perfected and not market ready. Levitt points to his June 23, 1997, review of Speed Control's business plan. He also cites to an August 14, 1997, letter from Seline to Waitt and Levitt in which Seline notes that "the issues Tom raised will be tough questions for them to answer." Levitt App., Ex. 18, App. pp. 87. The reference to the issues raised by Levitt is apparently an allusion to Levitt's letter of August 4, 1997. Although Levitt was critical, in his August 4, 1997, letter, about the management of Speed Control and its current production strategy, Levitt observed that "[t]he CVT for a bicycle is operable & capable of production. The prototype is a success." Speed Control App., Ex. 84, App. pp. 3. In addition, there is nothing in the record that Levitt ever retracted, modified or otherwise corrected these conclusions contained in his August 4, 1997, letter to Seline and Waitt. Moreover, Waitt testified in his deposition that Levitt was "always very positive" about the CVT and the Speed Control investment until sometime after Waitt's first investment. Waitt App., Ex. 92, pp. 57, 69. Thus, the court concludes that a material fact question has been generated as to whether Waitt knew that the CVT was not perfected and not market ready at the time of his first investment in Speed Control. Therefore, this portion of Levitt's motion is also denied.

v. Waitt ended the due diligence period

Levitt next contends that Waitt and Seline themselves ended the due diligence period when they made Wait's first investment into Speed Control. In support of his argument, Levitt notes that on September 29, 1997, Levitt sent a confirmation fax to Seline regarding documents that were executed by Waitt to close the transaction on Waitt's initial investment in Speed Control. Levitt App., Ex. 33, App. p. 147. In his fax, Levitt noted that he considered that "this transaction has closed or will close very soon in due course." Levitt App., Ex. 33, App. p. 147. This document, however, does not indicate that the close of the transaction was against the advice of Levitt nor does it indicate that Levitt's receipt of these documents came as a surprise to him. Indeed, the document is entirely silent on the key question of whether Waitt prematurely terminated the due diligence period.

Levitt also directs the court's attention to Levitt's August 6, 1997, faxed note to Seline in which he reported that:

> 1. Speed Control is amassing debt @ an alarming rate and a liquidity crisis is at hand. Norm's participation will delay crisis and the totality of company progress together with proposed cash infusion needs more review/consideration before we can properly state our assessment. This may be enough cash @ $1.5M, but it may be insufficient. (I realize NWW is considering only $750K or $500K).
>
> 2. My remarks from correspondence to you & NWW dated yesterday continue to be accurate & are incorporated here by reference.
>
> 3, The financials coupled with out review of the company structure suggest a restructure is necessary to enhance likelihood of success.

Levitt App., Ex. 31, App. p. 144. Although Levitt states in his August 6, 1997, letter that more review is necessary, it does not necessarily follow that Levitt maintained the same

view nearly two months later, when Waitt made his first investment in Speed Control. In his August 29, 1997, letter reviewing the Amended and Restated Article of Incorporation and Investors Rights Agreement, Levitt advised Seline: "I recommend that you request documents regarding the assignments of patents to the corporation together with any employment or related agreements on incentives or employment conditions that would apply to key or other employees in the company, past, present, or future." Levitt App., Ex. 21, App. p. 91. Again, however, this is more than a month before Waitt made his first investment in Speed Control.

In resistance, Waitt points to his deposition testimony in which he indicated that he would not have gone forward with the transaction without Levitt's concurrence. Waitt App., Ex. 92, p. 69. The inference that may be drawn from this statement is that Waitt would not have closed the due diligence period without Levitt being on board with the decision. Given the sketchy record before the court, the court concludes that a material question of fact exists on the question of whether Waitt or Seline prematurely terminated the due diligence period. Therefore, this portion of Levitt's motion is also denied.

vi. Lack of complaint about Levitt's performance

Levitt also argues that summary judgment should be granted because Waitt did not complain about Levitt's performance. The fact that Waitt did not complain about Levitt's performance prior to his initial investment in Speed Control is hardly a controlling inquiry on the question of whether Levitt was negligent in the performance of his duty to Waitt. The fact that Waitt did not complain about Levitt's performance is open to several interpretations. One interpretation is that Waitt was satisfied with Levitt's performance. However, another is that Waitt was unaware of deficiencies in Levitt's performance until after he had made his initial investment in Speed Control. Thus, the court concludes that a material question of fact exists on the question of the reason for Waitt's lack of complaint about Levitt's performance prior to his first investment. Therefore, this portion of Levitt's

motion is also denied.

vii. Injury to Waitt

Levitt asserts that summary judgment should be granted in his favor with respect to Waitt's first investment in Speed Control because Waitt has not been injured as a result of this investment. Waitt responds by arguing that his initial investment of $750,000 is worthless. The court concludes that as to this issue, Levitt, as the moving party, has not met his initial responsibility of "identifying those portions of the record which show lack of a genuine issue." *Hartnagel*, 953 F.2d at 395 (citing *Celotex*, 477 U.S. at 323); *see also Rose-Maston v. NME Hosps., Inc.*, 133 F.3d 1104, 1107 (8th Cir. 1998); *Reed v. Woodruff County, Ark.*, 7 F.3d 808, 810 (8th Cir. 1993). Levitt does not identify that portion of the record which establishes that Waitt has not suffered damage as a result of his initial investment in Speed Control.

Finally, Levitt also argues that Waitt does not contend that Levitt misled him regarding the initial investment, and that therefore, Waitt cannot prove a legal malpractice or breach of fiduciary duty claim against Levitt because he cannot establish that Levitt was the proximate cause of any harm to Waitt. The court agrees. Because Levitt was not appointed to Speed Control's Board of Directors until after the first investment was made, Waitt cannot point to any genuine conflict of interest that Levitt had at the time he offered his advice to Waitt. The fact that Levitt had a law license in the State of Washington and owned an apartment complex in the same city as Speed Control's headquarters does not generate a genuine issue of material fact that Levitt had some ulterior motive or conflict of interest to recommend that Waitt invest in Speed Control.

Waitt has failed to put forth admissible evidence that would establish that Levitt was the proximate cause of any injury caused by his first investment. Indeed, in his deposition, Waitt admitted that he did not contend that Levitt had misled him regarding Waitt's initial investment in Speed Control. Waitt testified as follows:

> Q. Is it one of your contentions in this matter that Mr. Levitt somehow misled or misguided you regarding the initial investment of $750,000 in Speed Control?
>
> A. No I don't.

Waitt App., Ex. 1, App. p. 8.

Although Waitt claims that one of the grounds of his negligence action is that Levitt was incorrect in his assessment that the CVT transmission was operable and manufacturable, the court concludes that Waitt has failed to generate a genuine issue of material fact regarding whether Levitt breached a professional standard of care in his assessment of the CVT transmission. Waitt does not cite the court to any deposition testimony of his expert witness, Mark L. Tuft, or any other witness, that would establish that Levitt's actions with respect to the first investment fell below the appropriate standard of care. Moreover, Waitt has not established that this breach of a standard of care caused Waitt's injury with respect to his first investment in Speed Control. Thus, the court concludes that because Waitt has failed to create a triable issue on the question of whether Levitt was the proximate cause of any harm to him regarding his first investment in speed control, Levitt's motion for summary judgment is granted as to Waitt's first investment in Speed Control.

c. Waitt's second investment

With respect to his second investment in Speed Control, Waitt asserts that Levitt was negligent and breached his fiduciary duty because he failed to exercise the proper standard of care under the circumstances. Waitt also asserts that Levitt violated his duty to avoid conflicts of interest or handle any conflicts of interest in a reasonable and prudent manner. In his motion for summary judgment, Levitt asserts the following defenses against Waitt's claims against him with respect to Waitt's second investment: that Seline put Levitt on Speed Control's Board of Directors with knowledge of Levitt's "overlapping

responsibilities" as both a director and a representative of Waitt; that Seline approved of Levitt assuming the positions of President and CEO of Speed Control; that Waitt knew of Levitt's assuming the positions of President and CEO of Speed Control at the time of the second investment; and, that Waitt has no memory of the second investment. The court will again proceed to address each of these arguments *seriatim*.

i. Knowledge of conflicts

Initially, Levitt asserts that Seline placed him on Speed Control's Board of Directors with full knowledge of the dual responsibilities that Levitt would assume as a board member and as a representative of Waitt. Levitt further contends that neither Seline nor Waitt perceived any conflicts created by having Levitt serve on Speed Control's Board of Directors.

Rule 3-300 of the California Rules of Professional Conduct provides:

> A member shall not enter into a business transaction with a client; or knowingly acquire an ownership, possessory, security, or other pecuniary interest adverse to a client, unless each of the following requirements has been satisfied:
>
> (A) The transaction or acquisition and its terms are fair and reasonable to the client and are fully disclosed and transmitted in writing to the client in a manner which should reasonably have been understood by the client; and
>
> (B) The client is advised in writing that the client may seek the advice of an independent lawyer of the client's choice and is given a reasonable opportunity to seek that advice; and
>
> (C) The client thereafter consents in writing to the terms of the transaction or the terms of the acquisition.

CALIFORNIA RULES OF PROFESSIONAL CONDUCT 3-300. "Rule 3-300 was intended to regulate two types of activity: business transactions between attorneys and clients and the acquisition by attorneys of pecuniary interests adverse to clients." *Santa Clara County Counsel Attys. Assn. v. Woodside*, 7 Cal.4th 525, 545, 869 P.2d 1142, 1152, 28 Cal. Rptr. 2d 617, 627 (1994). A violation of any part of this rule gives rise to culpability. *Cf. Read*

v. State Bar 53 Cal.3d 394, 411, 807 P.2d 1047, 1052, 279 Cal. Rptr. 818, 823 (1991) (construing the predecessor to rule 3-300, whose language was substantially identical to that of the current rule 3-300).

In response to Levitt's motion, Waitt asserts that Levitt violated his professional ethical duties to Waitt and cites the court to the deposition testimony of his expert witness, Mark L. Tuft. Waitt App., Ex. 102. Tuft concludes that an attorney-client relationship existed between Levitt and Waitt from early 1990 until January 10, 2000. Waitt App., Ex. 102, p. 74. Tuft noted that in his review of legal documents related to this case he had not seen a written conflict of interest disclosure sent to Waitt by Levitt. Waitt App., Ex. 102, pp. 195-96. Tuft explained the significance of Levitt's failure to obtain a written informed consent and waiver by Waitt to the conflict:

> It is not only that he didn't put it in writing to his client. To say it differently, I do not have the impression that Mr. Seline was either appointed as or qualified as a lawyer to ensure that Mr. Levitt's fiduciary obligations were being met. I did not see that anywhere in the documents that I reviewed.
>
> I believe Mr. Levitt had an independent duty to his client, regardless of what other advisors were claiming he had, to explain to his client what the relevant circumstances were of this new relationship--clearly it was a material change--and what the foreseeable consequences were, not only at the onset when the idea was being discussed but at the other strategic points in time when the circumstances rose to a conflict. I don't think that happened.

Waitt App., Ex. 102, pp. 110-11.

The court notes that Levitt does not site the court to any portion of the record in which Waitt was apprised by Levitt of the possible conflicts created by Levitt taking a seat on Speed Control's Board of Directors while at the same time continuing to retain his

services, including investment advice related to Speed Control.[9] Indeed, Levitt asserts that neither Waitt nor Seline perceived any conflicts created by Levitt sitting on the Board of Directors of Speed Control. The fact that Waitt was unaware of the possible conflicts of interests created by Levitt becoming a board member does not relieve Levitt of his duty to follow the canons of the legal profession. Indeed, it is precisely because a client may not be aware of the dangers posed by such a situation that the ethical rules, such as Rule 3-300, were intended to redress. Therefore, this portion of Levitt's motion is also denied.

ii. Waitt came to understand Speed Control through Levitt's work

Levitt also argues that after he become a member of Speed Control's Board of Directors he apprised Waitt of the inner workings of Speed Control. Although Levitt maintains that he warned Seline in a July 27, 1998, conversation about defects in the CVT, the only portion of the record he sites to support this proposition is a cryptic hand written, note made by Levitt. Levitt App., Ex. 42, App. p. 162. This assertion is refuted by Waitt in his affidavit, in which he maintains that:

> At no time did anyone tell me that the company did not have a CVT capable of manufacture, that there were problems with the CVT components, that there needed to be significant change to the CVT design, that the CVT frequently broke, or that there were any significant design problems.

Waitt App., Ex. 91, ¶ 39. Thus, the court concludes that a genuine issue of material fact exists as to the issue of whether Levitt apprised Waitt of the defects in the CVT prior to Waitt's second investment in Speed Control. Therefore, summary judgment is denied on this argument.

iii. Seline approved Levitt's change in role

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[9]Indeed, the court notes that the portion of the record cited by Levitt fails to disclose that Waitt was informed by Seline of the possible conflicts. *See* Levitt App., Ex. 2, app. p. 20.

Levitt next contends Seline approved Levitt's assuming the position of Speed Control's President and CEO. Although the record supports the proposition that Seline knew and approved of Levitt taking the position of President and CEO of Speed Control, Levitt fails to cite to any portion of the record in which Waitt was apprised by Levitt of the possible conflicts of interest created by Levitt assuming the positions of President and CEO while at the same time continuing to provide services to Waitt, including advice regarding Waitt's investment in Speed Control. Therefore, this portion of Levitt's motion is also denied.

iv. Knowledge of Levitt's role at the time of the second investment

Levitt further contends that at the time of Waitt's second investment in Speed Control, Waitt and Seline obviously knew of Levitt's role as President and CEO of Speed Control. Again, the court does not believe that the record is uncontested that Waitt knew that Levitt had assumed the role of President and CEO of Speed Control at the time of his second investment in the company. However, as the court has discussed above, Levitt does not direct the court's attention to any portion of the record in which Waitt was apprised by Levitt of the possible conflicts created by Levitt occupying these two positions while at the same time continuing to provide his legal services to Waitt on matters related to Speed Control. Therefore, this portion of Levitt's motion is also denied.

v. Lack of memory of second investment

Levitt finally contends that neither Seline nor Waitt have any memory of Waitt's second investment in Speed Control. Levitt argues that as a result, Waitt cannot sustain his claim that he was mislead by Levitt regarding his second investment in Speed Control. Although the portion of the record cited by Levitt with respect to Seline, does support the proposition that Seline does not recall Waitt's second investment, *see* Levitt App., Ex. 2, App. p. 22, the portion of the record Levitt cites with respect to Waitt does not establish that Waitt has no memory of the investment. Rather, Waitt testified as follows:

> Q. So we get into 1999, and Maury Nieland has discussed with you a little bit about the next investment, the 130. And I think you mentioned earlier that when you were thinking about this initially you had kind of forgotten about that amount; is that correct?
>
> A. Yeah. I just remember sometime that they were in need of some more cash. And, you know, it was always kind of, well, what's the minimum that they could get by on? And I think that looks like--it was kind of an odd number so I'm not sure where the number even came from, how it even--it wasn't an even number like the other two. So it must have just been some sort of calculated shortfall of some sort.

Levitt App., Ex. 1, App. p. 13. Thus, the court finds Waitt's deposition testimony to be less than clear-cut on the question of whether Waitt remembers his second investment in Speed Control. Moreover, in response, Waitt directs the court's attention to the following portion of his affidavit in which he avers:

> In late 1998, Mr. Levitt advised that the company was in need of additional capital to complete final market testing so that the company could begin sales. I initially indicated that I would decline to invest. However, Mr. Levitt advised that the company needed additional capital and that without the additional capital the company could not move forward into production. Since I knew my investment would be worthless if the company did not move forward with a product, and since I understood that this additional capital was to be used for market testing, I consented to an additional investment in January 1999 in the amount of $130,540.00 for which I received 65,270 shares. At no time did anyone tell me that the company did not have a CVT capable of manufacture, that there were problems with CVT components, that there needed to be significant change to the CVT design, that the CVT frequently broke, or that there were any significant design problems.

Waitt App., Ex. 91, ¶ 39. Thus, the court concludes that Waitt has succeeded in generating

a genuine issue of material fact on the question of whether Waitt has a memory of his second investment in Speed Control. Therefore, this portion of Levitt's motion is also denied.

d. Waitt's third investment

Defendant Levitt also seeks summary judgment with respect to Waitt's third investment in Speed Control. Levitt's argument here is that Waitt cannot support his claim for legal malpractice or conflict of interest with respect to Waitt's third investment in Speed Control. Levitt contends that by the time of Waitt's final investment in Speed Control, Waitt was relying on information and recommendations from Rix. Levitt, however, relies primarily on cryptic, hand written notes he made regarding conversations he had with Rix. Levitt App., Exs. 69, 74-77. Moreover, this argument is contested by Waitt. Waitt asserts that Levitt continued to encourage Waitt about the progress being made on the CVT, and continued to claim that the company had a product that was capable of being mass produced. Waitt asserts that these claims by Levitt were not true. Waitt also argues Levitt continued to withhold information regarding engineering problems that Speed Control was experiencing with the CVT. Waitt avers as much in his affidavit:

> 44. In correspondence dated September 10, 1999, apparently intended to respond to Mr. Rix's letter, Mr. Levitt indicated that [Speed Control] development was ready to enter the final state of preparation for "mass production". This correspondence included a letter from Mr. Mills which responded to Mr. Rix's analysis. In his letter, Mr. Mills indicated that he believed "A market exists for this transmission as it is presently configured. There is simply no question about this point." I understood this to mean that the company had a product that was ready to manufacture and sell to the public. Mr. Mills letter further indicated, in response to Mr. Rix's suggestion that there be a focus on improving the shift, that that was not necessary because riders who had ridden the prototype found it "very easy to shift". The

> clear implication of this letter from Mr. Mills was that the company had a 1st generation product ready to market, and that any further necessary refinements could be incorporated into the second generation upgrades. . . .
>
> 45. From conversations with Mr. Levitt, Berglund and Huse, I understood at this time, in September 1999, that the company needed an additional capital infusion to complete the product and move it into production. In reliance upon the recent statements by Levitt and Mr. Mills, as well as the fact because no one had detailed for me the internal failures of the CVT or the prohibitive manufacturing costs, I made an additional investment. I made this investment in large part because I understood that my prior investments would be rendered worthless if no investment was made because the company would run out of cash soon. If I had been told that the company was going to soon abandon Mr. Mill's CVT, I would never have invested this additional money.

Waitt App., Ex. 91, ¶¶ 44-45.

Given the record before the court, the court concludes that questions of material fact have been generated on such questions as whether Levitt failed to disclose material information to Waitt regarding the CVT prior to Waitt's third and final investment in Speed Control, and whether Levitt actively misrepresented to Waitt the state of the CVT's development. Thus, because the court concludes that Waitt has succeeded in generating genuine issues of material fact, this portion of Levitt's motion is also denied.

5. Challenges to specific paragraphs of the complaint

The court will next address Levitt's challenges to nine paragraphs of the complaint: 15, 16, 17, 21, 22, 26, 32, 38 and 39. Levitt seeks summary judgment as to the allegations contained in these nine paragraphs on the ground that they are not supported by evidence. The court will address Levitt's arguments regarding each of these paragraphs in turn.

a. Paragraph 15

Waitt alleges in paragraph 15 that:

> Defendant was not qualified to accept a position as President and Chief Executive Officer of Speed Control given that he had no prior executive experience with similar companies, and that he had neither sufficient training nor qualifications to accept such a position.

Levitt Complaint at ¶ 15. Levitt asserts that Waitt should be estopped from complaining about his qualifications because both he and Seline thought that it would be a good thing to have Levitt serve as Speed Control's President and CEO. Although Seline indicated during his deposition testimony that he thought that it would be "great" that Seline would be Speed Control's President and CEO, Levitt App., Ex. 2, App. p. 23, Waitt avers in his deposition that he was not comfortable with the idea of Levitt assuming these positions. Waitt App., Ex. 91, ¶ 35. Moreover, Waitt alleges that he acquiesced to the idea based on the belief that Levitt was going to assume the positions on an "interim" basis while Speed Control looked for a person to assume the role of president. Waitt App., Ex. 91, ¶ 35. Furthermore, neither party cites the court to that part of the record which contains Levitt's prior work history. Therefore, given the record before the court, the court concludes that questions of material fact have been generated with respect to the issues raised in paragraph 15 of the complaint. Therefore, this portion of Levitt's motion is also denied.

b. Paragraph 16

In paragraph 16, Waitt avers that: Defendant failed to advise the Plaintiff to seek independent counsel and advice as to whether Defendant was qualified to accept a position with Speed Control." Levitt Complaint at ¶ 16. Levitt argues that there was no need to advise Waitt to seek independent counsel because he was represented by counsel, Seline, at the time. While Waitt may have been represented by counsel, Levitt's argument does not address the question raised by this paragraph, whether he ever advised Waitt to have

independent counsel, whether it be Seline or another attorney, examine the question of his qualifications to assume the role of President and CEO of Speed Control. Therefore, this portion of Levitt's motion is also denied.

c. Paragraph 17

In paragraph 17, Waitt alleges that:

> At no time prior to accepting the position of President/CEO, or the role on the Board of Directors, did the Defendant advise the Plaintiff of having a potential or actual conflict of interest in continuing to represent Plaintiff relative to any duties he may owe to Speed Control or other shareholders, officers, directors thereof by virtue of accepting a position as an officer and director of the company.

Levitt Complaint at ¶ 17. For the reasons fully discussed above, *see* § II(B)(4)(c)(i), this segment of Levitt's motion is denied.

d. Paragraph 21

In paragraph 21, Waitt asserts that:

> In conjunction with his inducement for further investment, Defendant represented to Plaintiff and Plaintiff's agents in September 1999, and at other times, that Speed Control's product was ready for mass production. The Defendant's representations were false and misleading in that Speed Control did not have a product ready for mass production, and as of the date of the filing of this Complaint still does not have a product ready for mass production. Defendant either knew or should have known that Plaintiff would rely upon Defendant's advice and representation concerning Speed Control. Defendant further either knew or should have known that his statements regarding production were false and misleading in that there was no product ready for mass production, there were engineering deficiencies relating to the design of Speed Control's product, and there were questions as to the viability of Speed Control's patents, in addition to other concerns.

Levitt Complaint at ¶ 21. Levitt argues that it is uncontested that he never represented that the CVT was market ready. Waitt, however, avers in his affidavit that:

> 44. In correspondence dated September 10, 1999, apparently intended to respond to Mr. Rix's letter, Mr. Levitt indicated that [Speed Control] development was ready to enter the final state of preparation for "mass production". This correspondence included a letter from Mr. Mills which responded to Mr. Rix's analysis. In his letter, Mr. Mills indicated that he believed "A market exists for this transmission as it is presently configured. There is simply no question about this point." I understood this to mean that the company had a product that was ready to manufacture and sell to the public. Mr. Mills letter further indicated, in response to Mr. Rix's suggestion that there be a focus on improving the shift, that that was not necessary because riders who had ridden the prototype found it "very easy to shift". The clear implication of this letter from Mr. Mills was that the company had a 1st generation product ready to market, and that any further necessary refinements could be incorporated into the second generation upgrades.

Waitt App., Ex. 91, ¶ 44. Given the record before the court, the court concludes that a question of material fact has been generated as to whether Levitt actively misrepresented to Waitt the state of the CVT's development. Thus, this part of Levitt's motion is also denied.

e. Paragraph 22

In paragraph 22, Waitt asserts that:

> In conjunction with soliciting additional investment from Plaintiff in 1998 and 1999, Defendant further represented that the product engineering had been tested by outside consultants and that there was no problem with the product; that the product would be sold and marketed within a year of Plaintiff's additional investment; that other investors would match Plaintiff's additional investment; and that all that was needed

> was an additional investment from Plaintiff to complete any necessary steps to have a market-ready product which could be produced and sold on the market within months. These representations were false and misleading.

Levitt Complaint at ¶ 22.

Defendant Levitt asserts that an issue of material fact has not been generated as to the assertion that Levitt made representations in 1998 that the CVT would be marketed within one year. In response, Waitt directs the court to his deposition testimony in which he testified as follows:

> Q. Before you made the investment of January 29th of 1999, did you have any questions about the company, about the invention or about the transmission that were not answered for you?
>
> A. Not--my main question was always, when's this thing going to be ready to go, ready to sell? And the answer was always very--very short, within months.

Waitt App. Ex. 92, at p. 98. Waitt further alleges in his affidavit that:

> During the course of 1998, I did inquire about the status of product completion in my communication with Mr. Levitt. During all of these conversations Mr. Levitt repeated that they were addressing minor details and that they would have a product capable of sale within a matter of months.

Waitt App., Ex. 91, ¶ 38. Thus, given Waitt's deposition testimony and his affirmations in his affidavit, the court concludes that a question of material fact has been generated as to whether Levitt misrepresented to Waitt the product readiness of the CVT. Thus, this part of Levitt's motion is also denied.

f. Paragraph 26

In paragraph 26, Waitt alleges that:

> Defendant failed to advise the Plaintiff of the need to seek

> independent counsel due to the potential and actual conflict of interest asserted with Defendant's solicitation of additional investment funds from Plaintiff.

Levitt Complaint at ¶ 26. Levitt does not contend that he informed Waitt to seek independent counsel. Rather, Levitt asserts that because Waitt was also represented by Seline that he did not need to advise Waitt to obtain independent counsel. Waitt, on the other hand, asserts that Levitt violated his professional ethical duties to him and cites the court to the deposition testimony of his expert witness, Mark L. Tuft. Waitt App., Ex. 102. Tuft concludes that an attorney-client relationship existed between Levitt and Waitt from early 1990 until January 10, 2000. Waitt App., Ex. 102, p. 74. Tuft explained the significance of Levitt's failure to obtain a written informed consent and waiver by Waitt to the conflict:

> It is not only that he didn't put it in writing to his client. To say it differently, I do not have the impression that Mr. Seline was either appointed as or qualified as a lawyer to ensure that Mr. Levitt's fiduciary obligations were being met. I did not see that anywhere in the documents that I reviewed.
>
> I believe Mr. Levitt had an independent duty to his client, regardless of what other advisors were claiming he had, to explain to his client what the relevant circumstances were of this new relationship--clearly it was a material change--and what the foreseeable consequences were, not only at the onset when the idea was being discussed but at the other strategic points in time when the circumstances rose to a conflict. I don't think that happened.

Waitt App., Ex. 102, pp. 110-11. Given the uncertain state of the record, the court cannot conclude as a matter of law that Levitt did not violate a duty owed to Waitt to apprise him of possible conflicts of interest resulting from Levitt's role as President and CEO of Speed Control while at the same time continuing to provide his legal services to Waitt on matters

that included Speed Control. Therefore, this portion of Levitt's motion is also denied.

g. Paragraph 32

In paragraph 32, Waitt alleges that:

> Defendant breached his fiduciary duty and obligation as an attorney by failing to disclose to Plaintiff the conflict of interest inherent in Defendant's position with Speed Control, and in further failing to advise Defendant to seek the advice of independent counsel concerning the additional investments solicited from Plaintiff in 1998 and 1999.

Levitt Complaint at ¶ 32. Defendant Levitt asserts that he fully discussed with Waitt the possible conflicts that might exist with him occupying the role of President and CEO of Speed Control while still continuing as a legal advisor to Waitt. Levitt, however, has not cited the court to any portion of the record which supports the proposition that he actually informed Waitt of the possible conflicts. Rather, Levitt directs the court to his handwritten notes of conversations he had with Seline which purportedly show that Levitt informed Seline of the possible conflicts and that Seline waived the conflict of interest. The court notes, however, that Levitt does not cite the court to any part of the record which would establish that Waitt was informed by Seline of the possible conflicts. Waitt avers in his affidavit that:

> Mr. Levitt never discussed with me the potential conflicts of interest that might arise by virtue of his taking the position of President of Speed Control, nor did I ever receive any written document detailing the potential conflicts of interest or suggesting that I needed to have an independent lawyer examine this issue. I never executed any document waiving any conflict of interest for Mr. Levitt to serve as either a board member or President.

Waitt App., Ex. 91, ¶ 38. Thus, given the record, the court concludes that a question of material fact has been generated as to whether Waitt was aware of the possible conflicts

of interest caused by Levitt assuming the positions of President and CEO while at the same time continuing to provide services to Waitt, including advice regarding Waitt's investment in Speed Control. Thus, this part of Levitt's motion is also denied.

h. Paragraph 38

In paragraph 38, Waitt alleges that: "There is no market for Plaintiff's securities in Speed Control and his investment has been rendered substantially worthless." Levitt Complaint at ¶ 38. Defendant Levitt contends that the allegation contained in this paragraph is unfounded. Levitt, however, has not cited the court to anything in the record establishing a value for Waitt's Speed Control stock. Waitt notes that defendant Huse in his deposition stated that the Speed Control stock had been valued by an independent party at three cents a share. Waitt App., Ex. 94, p. 78-79. If this assessment is correct, then Waitt's stock in Speed Control is worth approximately $20,708.10. Although $20,000 is not an insignificant sum, given that Waitt invested over $1,300,000 in Speed Control, the court does not believe Waitt's description of the stock as "substantially worthless" to be fallacious. Therefore, this segment of Levitt's motion is denied.

i. Paragraph 39

In paragraph 39, Waitt alleges that: "Upon information and belief, the offices of Speed Control have been closed and no day-to-day employees remain at Speed Control's facilities." Levitt Complaint at ¶ 39. Defendant Levitt asserts that Speed Control has not shut down its operations. In support of his position, Levitt directs the court's attention to those portions of his deposition in which he testified that Speed Control still has "operations" in Richland, Washington and Minden, Nevada, and still has one permanent employee, who works part-time. Levitt App., Ex. 4, App. p. 36. In response, Waitt points out that Levitt testified at his deposition that Speed Control's office in Kennewick, Washington was closed and the three or four employees currently working at the facility were terminated at the time of closing. Waitt App., Ex. 96, pp. 252-53. Because it is

uncontested that Speed Control still has one permanent, part-time employee and has "operations" in two locations, the court will grant this portion of Levitt's motion and strike this portion of the complaint.

Although the court has denied the majority of defendants' respective motions for summary judgment, if the court were permitted to resolve the claims based on the record before it, the court would be inclined to rule in defendants' favor. However, the court is mindful that the Seventh Amendment reflects "an immutable preference that certain matters," such as the remaining disputes between the parties to this litigation, "be left to the collective judgement of a jury of peers, rather than reposed in a single, albeit industrious and well-meaning, district judge." *Kampouris v. St. Louis Symphony Soc'y*, 210 F.3d 845, 849-50 (8th Cir. 2000) (Bennett, C.J., dissenting). Thus, the court concludes that resolution of the remaining disputes in this litigation will have to await determination at trial.

III. CONCLUSION

Initially, the court concludes that defendants have not demonstrated that Waitt or a Waitt agent destroyed a monthly report willfully or in bad faith. Moreover, Waitt or his agent's negligence in losing the monthly report is insufficient to warrant the sanction of granting summary judgment in defendants' favor. Next, the court concludes that defendants have not established as a matter of law that Waitt's reliance on representations made to him by the Speed Control defendants was unjustifed. The court also concludes that Waitt has failed to plead fraud with particularity in paragraphs 14 and 15 of the Speed Control complaint. Thus, this portion of the Speed Control defendants' motion for summary judgment is granted. However, the court grants Waitt's request for leave to replead the claims contained in paragraphs 14 and 15. Therefore, Waitt must, *within fifteen (15) days* of this order, file **an amended complaint** adequately pleading fraud in paragraphs 14 and 15 pursuant to Rule 9(b). The Speed Control defendants' motion for summary judgment is

otherwise denied. The court further concludes that genuine issues of material fact have been generated that preclude the granting of defendant Levitt's motion for summary judgment as to Waitt's Second and Third investments in Speed Control. The court, however, **grants** Levitt's motion with respect to Waitt's first investment in Speed Control because Waitt has failed to create a triable issue on the question of whether Levitt was the proximate cause of any harm to him regarding the first investment in Speed Control. The court further finds that **paragraph 39 of the Levitt complaint should be stricken**. Therefore, the court **denies** all of defendant Levitt's motion for summary judgment with respect to Waitt's second and third investments in Speed Control, with the exception that the court orders that the allegations contained in paragraph 39 of the Levitt complaint be stricken, but **grants** Levitt's motion with respect to Waitt's first investment in Speed Control.

IT IS SO ORDERED.

DATED this 28th day of June, 2002.

Mark W. Bennett

MARK W. BENNETT
CHIEF JUDGE, U. S. DISTRICT COURT
NORTHERN DISTRICT OF IOWA